# APPENDIX

## In the Supreme Court of the United States

OCTOBER TERM, 1967

## No. 305

SECURITIES AND EXCHANGE COMMISSION,
PETITIONER

*v.*

NEW ENGLAND ELECTRIC SYSTEM, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE FIRST CIRCUIT

PETITION FOR CERTIORARI FILED JUNE 28, 1967
CERTIORARI GRANTED OCTOBER 9, 1967

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## APPENDIX TO THE BRIEFS

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| September 30, 1957 | Answer filed jointly by New England Electric System and all other Respondents. |
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| May 15, 1964 | Petition to review the order of the Commission filed in the Court of Appeals for the First Circuit. |
| January 6, 1965 | Heard before Aldrich, Sweeny and Wyzanski, JJ. |
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## FINDINGS AND OPINION OF THE COMMISSION

By Whitney, Commissioner

This is the final phase of proceedings instituted by us under Section 11(b)(1) of the Public Utility Holding Company Act of 1935 ("Act") for the purpose of determining the extent to which the electric, gas, and other operations of the holding-company system of New England Electric System ("NEES"), a registered holding company, may be retained under common control.

We previously found that the electric utility assets of the NEES subsidiaries meet the definition of a single integrated public-utility system,[1] and NEES has elected to retain those assets as its principal system. The chief remaining issue now before us is whether the gas utility subsidiaries of NEES, which concededly constitute a single integrated gas utility system as defined in the Act,[2] may also be retained as an additional integrated utility system under the standards prescribed in Section 11(b)(1) of the Act.

Hearings were held at which evidence in support of retention was presented by NEES and its subsidiaries ("respondents") and by the Department of Public Utilities of the Commonwealth of Massachusetts ("Massachusetts DPU") and evidence in opposition to retention was adduced by our Division of Corporate Regulation ("Division"). Proposed findings and briefs were filed, and we heard oral argument. Our findings are based on an independent review of the record.

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[1] *New England Electric System,* 38 S.E.C. 193 (1958).

[2] Section 2(a)(29)(B) of the Act defines an integrated gas utility system as ". . . a system consisting of one or more gas utility companies which are so located and related that substantial economies may be effectuated by being operated as a single coordinated system confined in its operations to a single area or region, in one or more States, not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation: *Provided,* That gas utility companies deriving natural gas from a common source of supply may be deemed to be included in a single area or region."

*Description of the NEES System*

NEES is a holding company controlling seven electric utility subsidiaries and eight gas utility subsidiaries. It also owns thirty percent of the outstanding stock of Yankee Atomic Electric Company through one of its electric utility subsidiaries and all the common stock of New England Power Service Company ("NEPSCO"), which provides various services to the entire system. The retail electric operations serve 824,000 customers in the states of New Hampshire, Massachusetts, Rhode Island, and Connecticut comprising a franchise area of about 4,600 square miles with a total population of over 2,300,000 people. As of December 31, 1958, the gross investment in electric plant and equipment was approximately $600,000,000 and gross revenues from sales of electricity in 1958 were approximately $143,000,000.[3] The NEES gas subsidiaries provide retail service to about 237,000 customers in Massachusetts only, in an area of 660 square miles with a population of approximately 1,032,000 people. Of this gas franchise area, about 494 square miles, or 75%, is also part of the franchise area of NEES' electric subsidiaries, and approximately 78% of the gas customers are also served with electricity by the NEES electric companies. The NEES gas subsidiaries and NEES' ownership of their common stock are as follows:

| Company | % Common Stock Ownership by NEES |
|---|---|
| Central Massachusetts Gas Company ("Central Massachusetts") | 100.00 |
| Lawrence Gas Company ("Lawrence") | 90.43 |
| Lynn Gas Company ("Lynn") | 93.76 |
| Mystic Valley Gas Company ("Mystic") | 99.41 |
| North Shore Gas Company ("North Shore") | 97.52 |
| Northampton Gas Light Company ("Northampton") | 100.00 |
| Norwood Gas Company ("Norwood") | 99.38 |
| Wachusett Gas Company ("Wachusett") | 100.00 |

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[3] The basic figures in the record are for the year ended December 31, 1958, the latest year for which audited financial statements were available at the time of the hearings, and 1958 has been used as a test year for the purposes of these proceedings.

Most of these gas properties were acquired by NEES in the period from 1926 to 1931. As of December 31, 1958, the NEES investment in gross gas plant and equipment was approximately $56,300,000 and gross revenue from gas sales in 1958 was approximately $22,700,000. The bulk of the gas sold by the NEES subsidiaries is natural gas produced in the southern United States, principally Texas, and purchased from pipeline companies that deliver it to Massachusetts.[4] Each of the gas subsidiaries also owns and operates facilities for the production of manufactured gas for peak-shaving and emergency stand-by purposes.

After an attempt to sell the gas properties in the early 1950's which was not consummated because of the prospective purchaser's inability to obtain required financing, in 1952 NEES separated various aspects of the activities of the gas subsidiaries from those of the electric companies. It established a Gas Division with headquarters at Malden, Massachusetts,[5] to supervise the 8 gas companies. The executive head of the Gas Division is also president of each of the gas companies and the staff of that Division are all part-time employees of each of the gas companies, and the salaries of those persons are paid pro rata by those companies. The Gas Division has four functional departments—management, marketing and supply, operations, and merchandising—and provides centralized service to the gas companies with respect to such matters as gas acquisition and distribution, engineering, sales promotion, and new business development. Each of the gas companies has a vice-president and general manager who is in immediate charge of the company and reports directly to the head of the Gas Division; the latter, in turn, is responsible to the NEES top management.

Other aspects of the gas and electric business have continued to be handled on a joint basis. Such joint ac-

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[4] Seven of the gas companies purchase natural gas from one pipeline, and the remaining company purchases such gas from another pipeline. About 98% of the natural gas is purchased from the first pipeline company.

[5] All of the gas companies are within 48 miles of Malden, except one which is 80 miles distant.

tivities include treasury and accounting services, meter reading, customer billing, labor negotiations and administration of employee programs, procuring insurance, purchasing operations, and joint use of office and other space and equipment. Some of these services are performed by NEPSCO on a contract basis with the individual system companies. NEPSCO's services include supervision of local accounting departments, preparation of tax returns and regulatory reports, and handling of rate, personnel and public relations matters. In 1958 NEPSCO's charges to the gas companies aggregated $317,000.

*Statutory Standards*

Section 11(b)(1) of the Act imposes requirements for geographic and economic integration which were designed to eliminate evils that Congress found to exist "when the growth and extension of holding companies bears no relation to . . . the integration and coordination of related operating properties."[6] Congress recognized that in the absence of clearly overriding considerations a utility system should have a management single-mindedly devoted to advancing the interests of its investors and consumers and not engaged, through the means of the holding company device, in operating other separate or competing utility or non-utility business. It accordingly laid down the basic requirement in Section 11(b)(1) that registered holding companies and their subsidiaries limit their operations to a single integrated public utility system and any other businesses reasonably incidental or economically necessary or appropriate to the operations of such system. Exemption from this requirement was provided in exceptional cases meeting specific geographic and economic tests. Under Clauses A, B and C of that Section, we must permit a holding company to continue to control one or more additional integrated public utility systems if we find that:

"(A) Each of such additional systems cannot be operated as an independent system without the loss

[6] Section 1(b)(4) of the Act.

of substantial economies which can be secured by the retention of control by such holding company of such system;

"(B) All of such additional systems are located in one State, or in adjoining States, or in a contiguous foreign country; and

"(C) The continued combination of such systems under the control of such holding company is not so large (considering the state of the art and the area or region affected) as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation."

It is well settled that gas properties and electric properties, since they pertain to different and competing utility businesses, do not constitute a single integrated public utility system,[7] and as noted NEES concedes that its electric and gas properties constitute two separate integrated public utility systems. Since NEES has elected to retain the electric properties as its principal system, the gas properties can be retained as an additional system under NEES' control only if the tests of Clauses A, B, and C above are satisfied. There is no question under Clauses B and C. Since all the NEES gas subsidiaries are located within Massachusetts, the standard of Clause B is met. Also the Division acknowledges, and we find, that the size of the combined gas and electric operations is not so large as to raise any substantial question under the standards of Clause C with respect to the advantages of localized management, efficient operation, and the effectiveness of regulation. The issue remains, therefore, whether continued control by NEES of the gas companies is necessary to prevent the loss of substantial economies within the meaning of Clause A.

Clause A was intended to limit the retention of utility systems in addition to the principal system controlled by

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[7] See *Columbia Gas & Electric Corp.*, 8 S.E.C. 443, 462-63 (1941); *The United Gas Improvement Co.*, 9 S.E.C. 52, 77-83 (1941); *The North American Co.*, 11 S.E.C. 194, 215-16 (1942), aff'd on other grounds *sub nom. North American Co.* v. *S.E.C.*, 133 F.2d 148 (C.A. 2, 1943); *Philadelphia Co.*, 28 S.E.C. 35 (1948), aff'd *sub nom. Philadelphia Co.* v. *S.E.C.*, 177 F.2d 720, 723 (C.A.D.C., 1949).

a holding company to situations where it could be shown that the additional systems were integrated in nature and "were so small that they were incapable of independent economic operation" [8] and had a "real economic need" for management together with the principal system.[9] Congress was aware that some loss of economies would usually result from the separation of jointly controlled utility systems,[10] but considered that continued joint management should be permitted only where separation would entail a loss of economies which would be substantial in the sense that they were important to the ability of the additional system to operate soundly. As stated by the United States Circuit Court for the District of Columbia:

> "Substantial economies," means something different and, we think, something more than substantial savings in operational expenses. Congress could have said that the divorcement shall not be decreed if the controlling utility or the controlled utility show at a hearing that the cost to operate the latter separately from the former would be substantially greater. If the Act can be construed as meaning just that, then

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[8] Remarks of Senator Wheeler following passage of the Act, 79th CONG. REC. 14479 (1935): "After considerable discussion the Senate conferees concluded that the furthest concession they could make would be to permit the Commission to allow a holding company to control more than one integrated system if the additional systems were in the same region as the principal system and were so small that they were incapable of independent economical operation. . . ."

[9] H.R. Rep. No. 1903, 74th Cong., 1st Sess., p. 71 (1935). See also *The North American Co.* v. *S.E.C.*, 327 U.S. 686, 696-97 (1946): "In essence [Section 11(b)(1)] confines the operations of each holding company system to a single integrated public utility system with provision for the retention of additional systems only if they are *relatively small . . . and unable to operate economically under separate management without the loss of substantial economies.*" (Emphasis added.)

[10] See Hearings before Committee on Interstate and Foreign Commerce on H.R. 5423, 74th Cong., 1st Sess. (1935), Pt. 2, pp. 1249, 1402-03, 1530-31, Pt. 3, pp. 2257-77, and before Committee on Interstate Commerce on S. 1725, 74th Cong., 1st Sess. (1935), p. 65.

> the severance ordered here is wrong. "Substantial economies" must mean, as was said in *North American Co.* v. *Securities and Exchange Commission*, 2 Cir., 133 F.2d 148, 152, "important economies." The required *importance* must relate to the healthful continuing business and service of the freed utility. But Congress was not so much concerned with the profit motive of utilities as with the evils that had become prevalent through combinations of utilities. It was first concerned with the wiping out of the evils which the practice of utility combinations had produced, and Congress only consented to dull the blade of its chosen weapon in proved hard cases. (Italics in original.)[11]

In light of the legislative background, as buttressed by court interpretation, demonstating that Clause A was meant to provide for a limited exception to the general policy expressed in the Section, we have held that the clause must be strictly construed and that a registrant seeking to retain an additional system has the burden of showing by clear and convincing evidence that such additional system cannot be operated under separate ownership without the loss of economies so important as to cause a serious impairment of that system.[12]

*Estimated Loss of Economies from Severance of Gas System*

In support of their position that severance of the gas subsidiaries from the NEES system would result in the loss of "substantial economies" within the meaning of

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[11] *Engineers Public Service Co.* v. *S.E.C.*, 138 F.2d 936, 944 (C.A.D.C., 1943).

[12] *Engineers Public Service Co.*, 12 S.E.C. 41, 60 (1942); *Philadelphia Co.*, 28 S.E.C. 35, 45-47 (1948), aff'd *sub nom. Philadelphia Co.* v. *S.E.C.*, 177 F.2d 720 (C.A.D.C., 1949); *Middle South Utilities Inc.*, 35 S.E.C. 1, 11 (1953); *The North American Co.*, 11 S.E.C., 194, 208-9 (1942), aff'd on other grounds *sub nom. North American Co.* v. *S.E.C.*, 133 F.2d 148 (C.A. 2, 1943); *Cities Service Power & Light Co.*, 14 S.E.C. 28, 137 (1943); *The Middle West Corp.*, 15 S.E.C. 309, 318 (1944); *Cities Service Co.*, 15 S.E.C. 962, 984 (1944).

Clause A, respondents rely essentially upon a study made for them by Ebasco Services Incorporated ("Ebasco"), management consultants with extensive experience in the utilities field, which showed that severance would bring an increase in operating costs. Based on Ebasco's supplemented study,[13] respondents' estimated increase in annual

[13] The study as initially presented assumed that each of the gas companies would be operated separately, it being respondents' view that, notwithstanding the gas companies are presently operated as a single integrated public utility system, the fact that they might be disposed of individually or in groups made it proper to consider the increase in costs which would be incurred under individual operation. Following objections by the Division that the proper approach required the assumption that the gas companies would continue to be operated together as a single system, rather than separately, the study was supplemented so as to provide for a Central Organization for the eight gas companies after severance. The study, as thus modified, indicated the estimated increase in annual operating costs of the gas system after severance would be $329,400 less than the increase estimated on the initial assumption of eight separate gas companies without any Central Organization.

It would be inappropriate to give any weight to the estimates of increased costs to the gas companies on the assumption of separate operations by each of them after severance. Both we and the courts have held that the loss of economies to be considered under Clause A is that pertaining to the additional integrated system sought to be retained (See *Engineers Public Service Co.* v. *S.E.C.*, *supra* note 11 at 944; *The North American Co.* v. *S.E.C.*, *supra* note 12 133 F.2d at 152; *Philadelphia Co.*, *supra* note 12, 28 S.E.C. at 52; *General Public Utilities Corp.*, 32 S.E.C. 807, 838-9 (1951)), and we find no basis for departing from this established interpretation of the Act in this case. Moreover, we noted in the *General Public Utilities* case at p. 835, note 33: "The severance study also estimated the 'loss of economies' upon the assumption that each of the gas divisions was a separate integrated public utility system. Since we have determined that the gas properties constitute a single integrated public-utility system, we have given no consideration to this aspect of the study."

Respondents' assertion that a sale of the gas properties as a single system may be difficult if not impossible to achieve is not borne out by the record and overlooks the fact that in 1951 NEES obtained three bids for its gas properties as a whole, which were then more extensive than those now held, even though as has been indicated the contract which was signed with the highest bidder was subsequently terminated because of the latter's failure to arrange necessary

operating costs of the gas system after severance would be $1,165,600.[14]

In analyzing the Ebasco estimate of increased costs to the gas system, it is necessary at the beginning to make a downward adjustment in the amount of $67,000, the amount by which NEPSCO's charges to the gas companies in 1958 would have been increased had a revised basis of payments authorized by us at the end of 1959 been in effect in 1958.[15]

We accordingly turn to the questions of whether the Ebasco estimate, thus reduced to $1,098,600, is an acceptable basis on which to determine the present issues and whether it indicates that the test of Clause A is met. The Division contends that the estimate is not valid because it attributes excessive amounts of expenses to the *pro forma* combined gas operations and that, even assuming increased costs as estimated, they do not represent

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financing. Moreover, it fails to consider other methods of divestment of the gas system as a whole. Thus, NEES' stock holdings in the gas companies could be placed in a new company the stock of which could be sold or distributed as dividends to the NEES stockholders over an appropriate period of time.

[14] The study also estimated that the costs of the NEES electric subsidiaries would be increased after severance by $804,800 per year. However, such increase is not a factor which could justify retention of the gas system if it is found that the latter can be economically operated independently of NEES. *General Public Utilities Corporation,* 32 S.E.C. 807, 838-9 (1951). The thrust of the statute is the limiting of interstate utility holding company operations to a single integrated utility system managed exclusively in the interest of its own investors and consumers and the restricting of ownership or domination of such a system by interests principally engaged in other activities. The Act is not directed at preserving the benefits which the principal activity derives from the joint ownership with the other activities. Moreover, it may be noted that in any event the asserted $804,800 loss of economies to the electric system cannot properly be viewed as "substantial" in light of the fact that it is but 0.56% of that system's electric operating revenues and 0.76% of its electric operating revenue deductions before Federal income taxes.

[15] Under the revision approved in 1959, NEES's payroll and related expenses were transferred to NEPSCO and were allocated to the companies benefiting from the services according to a designated formula.

the loss of substantial economies warranting retention of the gas properties under common control with the NEES electric system.

The Ebasco estimate is inadequately supported in a number of important aspects and leaves considerable doubts which respondents have not satisfactorily overcome in the record. Of the total estimated increase in the expenses of the gas companies after severance, $472,100 is attributed by Ebasco to so-called treasury and accounting costs, which comprise the categories of customer accounting, general accounting, machine accounting, stores accounting and miscellaneous services. The largest single item is with respect to customer accounting, as to which an increase in costs is estimated in the amount of $415,600 or approximately 40% of the total $1,098,600 estimated increase. In light of the fact that the supplemented Ebasco study, which assumed that the gas system would be operated on a combined basis, estimated the same increase in customer accounting costs as appeared in the original Ebasco study, which was based on the assumption that the companies would be operated separately, and in light of respondents' and Ebasco's failure adequately to explain why combined operations would not result in lesser amounts for such costs, we conclude that the $415,600 figure is overstated.

More specifically, one of the important items making up the estimated increase in the cost of customer accounting after severance is customer billing. Ebasco projected the gas billing costs on the basis of separate billing operations by each of the gas companies. Its estimate provides for the employment of additional personnel and rental of additional equipment by those companies to do their own billing.[16] At present, gas billing is done on a combined basis with one or more of the NEES electric companies in the case of each of the gas companies except Norwood,

[16] The exact cost attributable by Ebasco to the additional billing personnel and equipment in the case of each of the gas companies is not identified in the estimate, but in the case of Mystic and Lynn they would total $34,700.

the smallest of the companies.[17] However, respondents have not given any satisfactory reason why at least some form or forms of combined billing procedure could not be employed advantageously by the gas companies, in light of the fact that their aggregate of 237,000 customers is located in a relatively compact area.[18]

Also inadequately explained and casting doubt on the estimates of increases in customer accounting expenses is the disparity between the increases attribuated to the gas companies and those attributed to the electric companies. Thus, for example, in 1958 the cost of customer accounting jointly performed for Northampton and Northampton Electric Lighting Company was allocated $17,000, or $2.12 per customer, to the gas company, and $34,200, or $3.60 per customer, to the electric company; whereas under the *pro forma* estimates, the gas company's costs after severance would amount to $48,400, or $6.03 per customer, representing an increase of 184%, and those of the electric company would be $38,500, or only $4.05 per customer, an increase of 13%. Even accepting NEES' contention that customer accounting costs should be viewed together with the other treasury and accounting costs, a substantially similar disparity appears. Total treasury and accounting payroll costs of Northampton, according to respondents' estimates, would increase by 85% to $89,-300, or $11.13 per customer, while those of the North-

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[17] Wachusett and Central Massachusetts have their billing done by the NEES Central District Treasury Organization at Worcester. The billing for Lawrence is done jointly with that of Merrimack Electric Co. Lynn and Lynn Electric Company and Northampton and Northampton Electric Company also have joint billing operations for their respective gas and electric customers. Mystic's and North Shore's billing is done at Malden, together with the billing for Suburban Electric Company.

[18] The testimony of respondent's Ebasco witness clearly indicates that centralized billing is predominant in the utilities industry, and that savings would be effected thereby. However, although he expressed the opinion that central billing would not effect "too substantial" a saving for the severed gas companies, no attempt was made to determine whether, and the extent to which, such savings would be substantial.

ampton Electric Company would increase by only 24% to $88,900, or $9.35 per customer. Again in the case of Lynn and Lynn Electric Company, which jointly serve approximately the same territory and a comparable number of customers, and which have done their treasury and accounting work jointly, in 1958 the payroll costs allocated to the gas company amounted to $228,300, or $5.58 per customer, and those charged the electric company were $64,000, or $8.02 per customer. Under respondents' estimates the *pro forma* costs would increase by 71% to $390,133, or $9.53 per customer, for the gas company and only by 22% to $445,323, or $9.81 per customer for the electric company. The record fails to indicate the validity of these disproportionate effects on the customer accounting and the total treasury and accounting costs of the gas and electric companies upon severance. These areas of expense, in general, are related to the number of customers served and not the type of utility business conducted.

In view of respondent's burden of proof and the absence of a persuasive explanation on the record, Ebasco's failure to consider employment of combined billing procedures and its inadequately explained disparate treatment of certain effects of severance on the gas and electric companies, respectively, substantially impair the credibility and preclude the acceptance of its estimate of a $472,100 increase in treasury and accounting costs and, in turn, of its over-all estimate of increased costs (of which that figure is a material part) in the determination of whether severance would result in a substantial loss of economies.

Respondents contend that in addition to the estimated increased expenses to which they have assigned dollar amounts there will be other significant losses as a result of severance which are not measurable in dollars. They assert in particular that there would be a loss of experienced administrative, supervisory and long-range planning personnel and services. However, the Ebasco study purportedly estimated the costs of providing organizations for the gas companies which would supply appropriate

performance and standards.[19] Moreover, even assuming there would be some "intangible" losses, they must be regarded as part of the over-all effects of severance which normally accompany any reorganization of operations and which Congress must have anticipated when it provided that, other than in exceptional circumstances, separate utility systems should be under separate control. Further, we are unable to accept the suggestion that the NEES integrated gas system, the second largest gas utility operation in Massachusetts, would not be able to provide management and service comparable to that provided by other gas utilities in the state.[20] In that effort

[19] The Central Organization for the gas companies provided for under the supplemental Ebasco study is estimated to have an annual cost of $574,000 and would include executive and supervisory officials and personnel. It would be headed by a president with an annual salary of $40,000, as compared to the $25,000 salary paid in 1958 to the President of the NEES Gas Division, who is also president of the eight gas subsidiaries. A new position of Executive Vice President would be created, with the incumbent, whose duties would include assisting the president and supervising the other executives, receiving a salary of $25,000. Like the NEES Gas Division, it would have three assistants to the president and a sales manager, with functions and salaries similar to those at present except that the latter's salary would be $17,500, representing an increase of $4,000 per year, and reflecting additional sales promotion duties which would be delegated to him by the president. Twelve additional employees would be provided to handle public and personnel relations and safety and purchasing matters. The salaries of these latter employees would total $87,000, approximately the same amount paid in 1958 as salaries to locally employed personnel and NEPSCO for similar services.

[20] See *Cities Service Co.*, 15 S.E.C. 962, 982 (1944), where in rejecting a contention that deprivation of the services of a system service company would result in loss of substantial economies, we observed that:

> "to accept an estimate of present benefit from services rendered by system service companies as a measure of economies which would be lost as a result of independence requires us to assume that financial severance will cast operating units completely adrift, incapable of providing themselves with comparable benefits as cheaply either directly or through mutual arrangements with other operating units. We cannot make that assumption."

See also *The North American Company*, 11 S.E.C. 194, 210 (1942).

it would also have the benefit of the experience in unified gas operations gained by the Gas Division since its formation in 1952.

Even were we to accept the $1,098,600 estimate of loss of economies to the NEES gas companies, it would not lead us to conclude that such a loss is so substantial, when compared with the loss of economies involved in prior divestment cases and viewed in light of the objectives of the Act, as to warrant retention of the gas properties under common control with the NEES electric system. Although that amount is larger than the amounts involved in prior severance cases, we have previously pointed out that the test of the substantiality of the estimated loss is not in absolute terms but rather in relation to total revenues, expense and income.[21] In the instant case, the amount of the estimated loss of economies would be equal to 4.83% of the gas system's operating revenues, 6.03% of operating revenue deductions (excluding federal income taxes), and 23.28% of gross income and 29.94% of net income before federal income taxes. These ratios are lower or not significantly higher than corresponding ratios of gas systems whose divestment we have required on the ground that the estimated loss of economies was not substantial within the meaning of Clause A.[22]

Respondents and the Massachusetts DPU argue that an increase in operating costs would have an exceptionally

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[21] *Philadelphia Co.*, 28 S.E.C. at 49; *General Public Utilities Corp.*, 32 S.E.C. at 837.

[22] Attached as an Appendix is a table which compares the adjusted Ebasco estimate of loss of economies to the NEES gas subsidiaries with the estimated losses in the prior cases where similar computations were made, in all of which we ordered divestment of the additional system. We do not attribute any comparability to the present case to the gross income and net income ratios of the gas properties of Jersey Central Power & Light shown in that table, which are substantially higher than those of the NEES gas group, because the gross income of Jersey Central's gas department prior to any severance adjustments was found to be so low as to represent an unusually low rate of return on the amounts invested in that property. See *General Public Utilities Corp.*, 32 S.E.C. 807, 837 (1951).

adverse impact in the case of the NEES gas subsidiaries and therefore should be viewed as more serious than an equal dollar amount of increases in other cases because of the highly competitive position of gas in relation to fuel oil in the Massachusetts area. They point out that natural gas is piped from Texas and the price is higher in the New England area than in any other part of the country, whereas oil is brought in by tanker and its price is virtually the same as or lower than in any other part of the United States. The chief market for gas in the NEES area is residential space heating, and Ebasco estimated that the annual cost of gas for heating a typical New England house is $166, as compared with the cost of oil of $173, whereas in other parts of the United States the differential ranges from $27 to $118 in favor of gas. It is contended that an increase in the cost of gas operations as a result of severance would force an increase in gas rates to customers, and that such an increase would impair the slight competitive advantage now held by gas.

However, even assuming that the described competitive conditions in Massachusetts will continue to prevail, despite efforts to improve the cost position of gas through such means as storage of off-peak natural gas, those conditions obtain generally throughout Massachusetts. There is no evidence that they do not affect in the same manner other independent gas utility companies in the state which nevertheless have been able to conduct their operations and, apparently, earn a fair return without the alleged advantages of common control with electric utilities by a holding company. The situation of the independent companies is different, respondents contend, because the opportunity for increased sales in the NEES gas service area is limited by a more moderate rate of economic growth, population increase, and suburban housing construction than in other parts of the state.[23] However, respondents failed to show that, because of these factors,

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[23] Respondents point out that between 1950 and 1960 the population in the NEES franchise areas increased by only 11% while in the franchise areas of seven independent Massachusetts gas companies used by the Division for comparison (see p. 13, *infra*) the increase was 18%.

the impact of severance would be such that the combined NEES gas operations, which are larger than those of most of the other gas utility companies in Massachusetts, would be unable to compete effectively with oil, even though the nonaffiliated companies are able to do so.[24]

Moreover, the operating ratio[25] of the NEES gas system after severance of 76.41% would be more favorable or only slightly higher than that of nine nonaffiliated Massachusetts gas companies selected by respondents for comparison that have no joint electric operations, which have a composite ratio of 79.14% and median and mean ratios of 74.87 and 76.35%, respectively.[26] In light of the fact that the operating ratio of the NEES gas companies, even considering Ebasco's estimated increased costs, would still be substantially favorable in comparison with the independent Massachusetts companies, we would be entering the realm of speculation at this time to assume that rate increases would ensue from severance. Especially is this so in view of our finding that these increased cost estimates, on which respondents and the Massachusetts DPU rely in stating that gas rates would have to be increased upon severance, are overstated.

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[24] Of 12 nonaffiliated Massachusetts gas companies which respondents selected for comparison with NEES, only one exceeded the NEES gas utility system in size of gross plant, gross annual revenues, and number of customers. It may also be noted that the NEES gas system is substantially larger than systems we have ordered divested in prior cases, such as those whose pertinent data are set forth in the Appendix table. We found that several of those systems in turn were larger than companies that had demonstrated conclusively their ability to operate effectively free of holding company control. See *Philadelphia Co.*, 28 S.E.C. 35, 46-7 (1948); *Middle South Utilities, Inc.*, 35 S.E.C. 1, 11 (1953).

[25] "Operating ratio" as used above is the percentage of total operating revenue deductions (other than depreciation, amortization of conversion costs, and Federal income taxes) to total operating revenues.

[26] The nine independent Massachusetts gas companies and their operating ratios are: The Berkshire Gas Co., 74.06%; Boston Gas Co., 82.5%; Brockton Taunton Gas Co., 74.59%; Buzzards Bay Gas Co., 73.77%; Fall River Gas Co., 77.31%; Haverhill Gas Co., 74.87%; Lowell Gas Co., 75.75%; Springfield Gas Light Co., 74.65%; and Worcester Gas Light Co., 79.64%.

We also find no merit in respondents' contention that in order to avoid reduction of gas net earnings after severance, gas operating revenues would have to be increased by additional revenue of approximately $1,500,000, consisting of $1,098,600 to offset the estimated increased costs plus about $400,000 to offset, on a two-dollar for one-dollar basis, the asserted nonavailability to the gas companies of an estimated $200,000 of tax reductions presently resulting from joining in the consolidated income tax return filed by the NEES system. The test of Section 11(b)(1) governing the retainability of additional public-utility systems is not based upon reduction of net earnings upon severance but rather solely upon whether the increased operating costs occasioned by severance are "substantial." With respect to the claimed nonavailability of consolidated tax savings, we have held on prior occasions that any such saving is not related to any operational function of retention of control and is not an appropriate factor upon which to determine retainability of an additional system.[27] In addition, it does not appear that a gas holding-company system that would emerge after severance would not be able to secure all or substantially all of the tax benefits now available to the gas companies under NEES ownership. Moreover, respondents did not show any reason why the consolidated debt ratios (including the effect thereon of NEES' own corporate debt) that now appertain to the NEES gas companies and affect the system's consolidated income tax liability would not also be imputed to the new gas holding-company system.

Respondents have also argued that in reaching the conclusion in prior cases that estimated losses of economies were not substantial we considered that separation of the management of the gas or other properties of the additional system from that of the principal system would result in offsetting advantages. They assert that there would be no such advantages in separation of the NEES gas companies because, as a result of the creation of the

[27] *Philadelphia Co.*, 28 S.E.C. 35, 73 (1948); *Cities Service Co.*, 15 S.E.C. 962, 985 (1946).

NEES Gas Division in 1952, the benefits that flow from centralized and separated operation of the gas business have already been achieved.

We cannot accede to the view that such a separation of the gas from the electric operations has been effected as to secure the kind of single-minded management for each that would obtain upon actual divestment. Although the NEES Gas Division handles sales and promotional activities and various other matters for the gas subsidiaries separately from the electric companies, final authority on all important matters rests in the top NEES management. The basic competitive position that exists between gas and electric utility service within the same locality [28] is affected by such vital management decisions as the amount of funds to be raised for or allocated to the expansion or promotion of each type of service. It is asserted by respondents and the Massachusetts DPU that NEES has made all such decisions with full regard for the needs of the gas companies, has vigorously promoted the gas business, and has not suppressed that business in favor of the NEES electric business. The Division points to the fact that of twelve independent Massachusetts gas companies used by respondents for comparison with NEES, seven which the Division considered comparable had substantially higher mcf sales and revenues per customer than the NEES gas companies [29] and their cus-

[28] See *Philadelphia Co.*, 28 S.E.C. at 48; *Engineers Public Service Co.*, 12 S.E.C. 41, 58 (1942).

[29] The NEES gas companies sold 44.2 mcf per customer in 1958 while sales of the 7 independent gas companies compared to NEES were 78.8 mcf per customer, 78% greater. In 1959 the NEES sales were 51.5 mcf per customer compared with sales of 83.7 mcf per customer by the independent group, or 63% greater.

Respondents object to the Division's elimination of Boston Gas Co. in making its comparisons. The Division considered that company not to be comparable to the NEES gas companies because it remained a distributor of lower btu manufactured or mixed gas until 1960, whereas the NEES companies distributed natural gas only. The difference in the nature of the gas sold is a material factor affecting comparability, but even were Boston Gas Company included the over-all comparison would not be substantially changed. Boston Gas Company's total gas sales were greater than those of the NEES group, being 57.0% mcf per customer com-

tomers pay less per mcf of gas consumed than the NEES gas customers.[30] It must be recognized that *prima facie* this disparity in favor of the independent companies, if it is at all meaningful, tends to indicate that the independent gas operations have been more effective than those of NEES gas management. Although the Massachusetts DPU argues that much of this disparity is caused by the difference in population characteristics of the NEES franchise areas and those of the independent companies because the latter had a more rapidly growing suburban residential population, no specific demonstration of the existence or extent of such a causal relation was presented. In any event, it is clear that the determinations respecting the basic interests of the gas companies are made by NEES officials who occupy a dual position in which they must weigh the needs and objectives both of those companies and of the electric companies which represent the principal and most profitable business of the NEES system. On the basis of the facts presented in this case we cannot conclude that a management solely interested in and devoted to the gas operations would not be able to advance them more effectively.

Respondents and the Massachusetts DPU further contend that in deciding whether substantial economies would be lost by severance of the gas companies we must accord great if not conclusive weight to that Department's views in favor of the retention of the gas properties within the NEES system. They argue that the Act reflects a Con-

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pared with 44.2 mcf for NEES in 1958, and 62.3 mcf per customer compared with 51.5 mcf for NEES in 1959, although in the area of domestic gas sales, Boston Gas sold less than the NEES group, its sales being 34.0 mcf per customer compared with 34.9 mcf for NEES in 1958 and 37.4 mcf compared with 56.1 mcf in 1959.

Revenue from gas sales by the NEES companies in 1958 was \$95.44 per customer compared with \$135.19 per customer for the 7 independent companies. In 1959 the comparable figures were \$104.49 for the NEES group and \$142.10 per customer for the independent group.

[30] The cost of gas to NEES customers in 1958 was \$2.16 mcf sold compared with \$1.72 per mcf for the independent group, and in 1959 NEES customers paid \$2.03 per mcf while customers of the independent gas companies paid only \$1.70 per mcf.

gressional recognition that the desirability of combined gas and electric operations is essentially a local question and indicates a policy of accommodation to the desires of local regulatory authorities on that question. They point to the fact that we have in prior cases granted exemptions from the Act under Section 3 and permitted separation from our jurisdiction pursuant to reorganization plans filed under Section 11(e) of companies having combined gas and electric operations. They cite in particular *Northern States Power Company*[31] which referred to those cases and expressly followed the recommendation of the local regulatory authorities in granting such an exemption.

We of course agree that the views of interested regulatory authorities should always be carefully considered, and have done so in this case. However, we do not view the statutory pattern as contemplating that the standards of Section 11 should yield to the views of state or local authorities whenever the properties whose joint retainability under that Section is in question are gas and electric properties. Section 8 of the Act, to which the Massachusetts DPU points particularly, requires state approval of acquisitions of gas and electric properties to be jointly owned or operated if state law prohibits or requires approval of such combination. However, it merely serves to prevent circumvention of express state restrictions against such acquisitions by imposing a condition of state approval even though acquisitions are otherwise permissible under the standards of the Act, and does not relate to the divestment of properties under the policy embodied in Section 11(b)(1). It must be read together with the provisions of Sections 9 and 10 which impose other conditions to acquisitions that apply even if all state laws are met and which are directed toward and embrace the standards of Section 11. Section 10(c) expressly provides that we shall not approve an acquisition which is unlawful under Section 8 or detrimental to the carrying out of the provisions of Section 11 or which we are unable to find would tend to promote the economical and efficient

[31] 36 S.E.C. 1 (1954).

development of an integrated public utility system. It is clear that the economic and geographic integration objectives of Section 11 were uppermost in Congress' mind in adopting Sections 9 and 10,[32] and that Section 8 was not intended to permit any relaxation of those objectives. There is significantly no reference in Section 11 to considerations of state or local policy, as there is in various other sections of the Act,[33] and the federal policy embodied in that Section is clearly paramount.[34]

We do not take the view that the Act expresses a federal policy against combined gas and electric operations as such. The Act is concerned with interstate holding company activities and within that area it prescribes tests of retainability which must be met. In the cases where we granted exemptions or otherwise released jurisdiction despite the existence of combined gas and electric operations, the holding companies involved did not come within that area because they and their subsidiaries were entirely intrastate or were primarily operating companies or because under the Section 11(e) reorganization plan which was to be effected no interstate holding company system with combined operations would survive. In exemption situations we are not required to determine whether the requirements of Clauses A, B and C of Section 11(b)(1) are satisfied; where the applicable geographic and operational requisites are otherwise met our inquiry with respect to the combined operations aspect is limited to determining whether it affirmatively appears that such operations would be detrimental to the public interest or the interests of investors or consumers. The *Northern States* case involved an application by a holding company which was also an operating company for an exemption from the Act pursuant to Section 3(a)(2), which provides for the exemption of a holding company

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[32] See S. Rep. No. 621, 74th Cong., 1st Sess. (1935), pp. 29-30; H. R. Rep. No. 1318, 74th Cong., 1st Sess. (1935), p. 15.

[33] *Cf.* Sections 6(b), 7(g), 8, 9(b)(1), 9(b)(2), 10(f) and 20(b).

[34] See *Public Service Commission* v. *S.E.C.*, 166 F.2d 784, 787 (C.A. 2, 1948), *cert. denied* 334 U.S. 838.

and its subsidiaries where the holding company is predominantly a public utility company. We found that the predominance test and geographic requirements of Section 3(a)(2) were met, and it was on the question of whether the record showed that the exemption would have a detrimental effect that we considered the favorable views of the local authorities and found that they together with other data presented by the applicant overcame the contention of the Division to the contrary which was supported by a study that we found to be unpersuasive.[35]

In the present case the issue is whether respondents, an interstate holding company system headed by NEES, have made the requisite showing under Clause A of Section 11(b)(1) that the losses from severance of the gas companies would be substantial. As has been stated, respondents rely on the Ebasco study. The Massachusetts DPU which has made no study itself, states that the estimates contained in the study conform to the losses of economies that its own familiarity with the NEES system would lead it to anticipate, and it joins in Ebasco's opinion that such losses would be substantial. We have seen that the study is deficient with respect to its principal item of estimated loss, thus materially impairing its persuasiveness and making it unacceptable. We have also been unable on the basis of the record before us to accept the

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[35] Respondents and the Massachusetts DPU also cite *Middle South Utilities, Inc.*, 35 S.E.C. 1 (1953), where in proceedings under Section 11(b)(1) the City of New Orleans recommended retention by New Orleans Public Service, Inc., a subsidiary of Middle South whose principal business was electric, of gas and transportation properties and we did not order divestment of those properties. However, one of the factors presented by the City was that it had purchase option rights which would have been lost by severance. It was partly because of that situation that we decided not to order divestment at that time but rather to defer decision on that issue, which is still pending. See S.E.C. 26th Annual Report, 133 (1960). In that same opinion we ordered separation of the gas properties of Louisiana Power & Light Company, another subsidiary, from its electric properties, and we subsequently refused to revoke or modify that order despite the position of the Louisiana Public Service Commission that independent operation of the gas system would increase expenses. *Middle South Utilities, Inc.*, 36 S.E.C. 383 (1955).

contention that there would be other significant losses not reflected in the dollar estimates or to find that the gas companies could not be soundly and economically operated independently of NEES, even assuming the validity of the estimates in the Ebasco Study. On the basis of our consideration of the entire record as to the nature and extent of the claimed losses, we cannot find that respondents have met their burden of showing that the test of Clause A for the retention of the gas properties under the control of NEES is satisfied.

*Conclusions*

In view of the foregoing we shall direct NEES to take appropriate action to divest itself of its interests in the system's gas properties.

The remaining issue in these proceedings relates to the retainability by NEES of its interest in NEPSCO. Since it appears that the operations of NEPSCO are reasonably incidental and economically necessary and appropriate to the operations of the integrated electric utility system of NEES, the proceedings will be dismissed insofar as they relate to the retainability of that company.

An appropriate order will issue.

Chairman CARY and Commissioners WOODSIDE and COHEN join in the above opinion.

ORVAL L. DUBOIS
Secretary

## ORDER OF THE COMMISSION

The Commission having instituted proceedings pursuant to Section 11(b)(1) of the Public Utility Holding Company Act of 1935 with respect to New England Electric System ("NEES") and its subsidiary companies to determine what action, if any, should be required to limit the operations of the system to a single integrated public utility system and to such additional systems and other businesses as are retainable under the provisions of Section 11(b)(1) of the Act;

The Commission having previously found that the electric utility properties of NEES constituted a single integrated public utility system within the definition set forth in Section 2(a)(29)(A) of the Act and having dismissed the proceedings relating to that issue while retaining jurisdiction over the remaining issues (38 S.E.C. 193 (1958));

A public hearing having been held after appropriate notice, at which evidence was adduced with respect to the remaining issues whether the gas utility assets of NEES are retainable by NEES as an additional integrated utility system and whether NEES may retain its interest in New England Power Service Company as a business whose operations are reasonably incidental or economically necessary or appropriate to the operations of the integrated electric utility system; and briefs and proposed findings and conclusions having been filed, and oral argument having been heard; and

The Commission having considered the record, and having this day issued its Findings and Opinion herein; on the basis of such Findings and Opinion

IT IS ORDERED, pursuant to Section 11(b)(1) of the Act, that the New England Electric System dispose of the gas utility properties presently controlled by it and terminate its relationship with the following companies by disposing of or causing the disposition, in an appropriate manner not in contravention of the Act or the Rules, Regulations or Orders of the Commission thereunder, of all interests, direct or indirect, which it holds in those companies:

Central Massachusetts Gas Company
Lawrence Gas Company
Lynn Gas Company
Mystic Valley Gas Company
North Shore Gas Company
Northampton Gas Light Company
Norwood Gas Company
Wachusett Gas Company

IT IS FURTHER ORDERED that the proceedings be, and they hereby are, dismissed insofar as they relate to the issue of whether the operations of New England Power Service Company are reasonably incidental and economically necessary and appropriate to the operations of the integrated electric utility system of New England Electric System and are retainable as such.

IT IS FURTHER ORDERED that jurisdiction be, and it hereby is, reserved to take such further steps as are necessary and appropriate to carry out the terms of this order.

By the Commission.

ORVAL L. DUBOIS
Secretary

| | Engineer Public Service Co. | | | | The North American Co. | | Philadelphia Co. | |
|---|---|---|---|---|---|---|---|---|
| | Gas Properties of Gulf States Utilities Co.—1940 | | Gas Properties of Virginia Electric and Power Co.—1940 | | Gas Properties of The St. Louis County Gas Co.—1942 | | Gas Group—1946 | |
| | Amount | Per cent of estimated loss of economies to: | Amount | Per cent of estimated loss of economies to: | Amount | Per cent of estimated loss of economies to: | Amount | Per cent of estimated loss of economies to: |
| Operating revenues | $638,711 | 6.58 | $1,057,000 | 3.38 | $2,748,770 | 5.85 | $16,656,560 | 3.00 |
| Operating revenue deductions (excluding Fed. inc. taxes) | $444,006 | 9.46 | $ 735,294 | 4.86 | $2,009,757 | 8.01 | $13,197,846 | 3.79 |
| Gross income (before deducting Fed. inc. taxes) | $201,594 | 20.85 | $ 317,890 | 11.25 | $ 742,027 | 21.68 | $ 3,565,357 | 14.03 |
| Net income (before deducting Fed. inc. taxes) | $166,402 | 25.25 | $ 168,412 | 21.23 | $ 661,110 | 24.34 | N.A. | N.A. |
| Estimated loss of economies claimed | $ 42,024 | | $ 35,750 | | $ 160,900 | | $ 500,328 | |

| | General Public Utilities Corp. | | | | Middle South Utilities, Inc. | | NEES | |
|---|---|---|---|---|---|---|---|---|
| | Electric Properties of Northern Pennsylvania Power Co.—6/30/49 | | Gas Properties of Jersey Central Power & Light Company—6/30/49 | | Gas Properties of Louisiana Power & Light Company—1954 | | Gas Properties of 8 Subsidiaries Combined—1958 | |
| | Amount | Per cent of estimated loss of economies to: | Amount | Per cent of estimated loss of economies to: | Amount | Per cent of estimated loss of economies to: | Amount | Per cent of estimated loss of economies to: |
| Operating revenues | $4,027,081 | 1.44 | $4,714,958 | 4.87 | $5,264,186 | 5.18 | $22,752,270 | 4.83 |
| Operating revenue deductions (excluding Fed. inc taxes) | $3,046,479 | 1.90 | $4,235,661 | 5.42 | $4,112,285 | 6.63 | $18,207,191 | 6.03 |
| Gross income (before deducting Fed. inc. taxes) | $ 981,980 | 5.90 | $ 479,477 | 47.84 | $1,151,901 | 23.68 | $ 4,718,864 | 23.28 |
| Net income (before deducting Fed. inc. taxes) | $ 855,101 | 6.77 | $ 202,582 | 113.24 | N.A. | N.A. | $ 3,669,931 | 29.94 |
| Estimated loss of economies claimed | $ 57,890 | | $ 229,398 | | $ 272,816 | | $ 1,098,600 | |

N.A. Not Available

# OPINION OF THE COURT OF APPEALS

June 4, 1965

ALDRICH, *Chief Judge.* This is a petition seeking to review and set aside a divestment order of the Securities and Exchange Commission pursuant to section 11(b)(1) of the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79k(b)(1), requiring the petitioner, New England Electric System (NEES) to dispose of its gas utility properties by terminating its relationship with its eight subsidiary gas companies. The ultimate question in the case, which the Commission resolved against NEES, was whether divestiture would cause the loss of "substantial economies" within the meaning of the cited section.

Briefly, NEES is a registered holding company controlling, at the time of the hearing, fourteen electric utility subsidiaries and eight gas subsidiaries, with some 824,000 retail electric customers in the states of New Hampshire, Massachusetts, Rhode Island and Connecticut, and some 237,000 retail gas customers in Massachusetts. Seventy-eight percent of its gas customers are also served by the electric companies. Except for certain peaks and emergencies the gas distributed is natural gas supplied by pipe line companies from the southern United States. The gas companies have separate offices and management, but their top officers are responsible to the top officials of NEES. There was a lengthy hearing before an examiner at which NEES sought to show that the cost of divestment to the electric system would be $804,000 annually, and to the gas system, if operated as a single unit after severance, $1,098,000.[1] The Commission held, *inter alia,* that the financial effect upon the electric system was not a relevant inquiry, but that if it was it was not significant. This we do not reach. It also held, which

[1] NEES' actual figure was $1,165,000, but the Commission reduced this by $67,000 as a result of a "revised basis of payments" authorized by it. NEES does not presently dispute this adjustment, but points out that the reverse adjustment must be made to the estimated electric system losses.

we do reach, that the claimed financial consequences to the gas system were not substantial as it construed the statute, but that if they were they had not been adequately proven.

Basic to its decision, as the Commission recognized at the outset of its opinion, is the meaning of the Act and the standards which it imposed. Briefly, section 11(b)(1) required divestiture unless NEES could satisfy the provisos or exceptions [2] contained in subparagraphs, or clauses, (A), (B) and (C). Clauses (B) and (C) were admittedly met. Clause (A) reads as follows:

> (A) Each of such additional systems cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system;

Before considering whether the Commission's interpretation of this clause was correct we must determine what its interpretation was. At the beginning of its opinion the Commission stated that to prevent divestiture NEES must show,

> that the additional systems were integrated in nature and "were so small that they were incapable of independent economic operation" and had a "real economic need" for management together with the principal system. Congress was aware that some loss of economies would usually result from the separation of jointly controlled utility systems, but considered that continued joint management should be permitted only where separation would entail a loss of economics which would be substantial in the sense that they were important to the ability of the additional system to operate soundly. [Footnotes omitted.]

The Commission then quoted at length from a decision by

[2] The Commission uses the word "exceptions," and criticizes NEES' word "provisos." NEES' distinction, as we read it, was in response to a heavy burden of proof which the Commission sought to attach to exceptions. See fn. 4, *infra*.

the Court of Appeals for the District of Columbia,[3] from which it drew the conclusion that clause (A) required a "showing by clear and convincing evidence[4] that such additional system cannot be operated under separate ownership without the loss of economies so important as to cause a serious impairment of that system." Lastly, at the end of its opinion, the Commission concluded that on the record it was unable "to find that the gas companies could not be soundly and economically operated independently of NEES, even assuming the validity of * * * [its] estimates."

Thus the statutory phrase, "cannot be operated as an independent system without loss of substantial economies," was said to mean, "incapable of independent economic operation;" "important to the ability * * * to operate soundly;" "so important as to cause a serious impairment of that system;" and "could not be soundly and economically operated."

In *Middle South Utilities, Inc.*, 35 S.E.C. 1, 11 (1953), its most recent decision cited in its opinion for the sup-

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[3] *Engineers Public Service Co.* v. *S.E.C.*, 138 F. 2d 936, 944 (1943). This case is extensively relied on in the Commission's opinion without noting that certiorari was granted, 322 U.S. 723 (1944), and the decision subsequently vacated as moot. 332 U.S. 788 (1947). This omission was remedied in its brief. We do not know whether the view of the majority, or the dissent of Judge Soper which accords with ours, would have ultimately prevailed.

[4] The Commission has been criticized before for using this phrase, the court allowing it to pass, however, on the ground that it meant no more than the fair preponderance of the evidence, the ordinary burden of proof. *Philadelphia Co.* v. *S.E.C.*, D.C. Cir., 1949, 177 F.2d 720, 725. We do not agree. This phrase has a well recognized meaning, and is applied in special cases, such as fraud, *Lackawanna Pants Mfg. Co.* v. *Wiseman*, 6 Cir., 1943, 133 F. 2d 482, 486, or mistake, *Philippine Sugar Estates Devel. Co., Ltd.* v. *Philippine Islands*, 1918, 247 U.S. 385, 391, as applied in *Aetna Ins. Co.* v. *Paddock*, 5 Cir., 1962, 301 F.2d 807, 811. The Commission is to be criticized for continuing to use this language, which by its tone suggests to laymen, as well as to lawyers, a heavy burden. We suspect, from other statements in its opinion, that it accurately revealed the Commission's approach. If so, in any future proceedings the Commission should readjust its receptivity as well as its phraseology.

port of its interpretation, the Commission ordered a divestment because it had not been shown that it would "cause the serious economic impairment of the system *or* that the gas properties could not operate effectively and efficiently under separate ownership." [Italics supplied.] Since presumably the Commission did not intend to voice simultaneously two different standards we read the word "or" as introducing an explanation or equivalency. Essentially this second *Middle South Utilities* phrase is the sole standard that the Commission adopts in its brief before us.

Also may be noted the Commission's statement, in refutation of one of NEES' contentions, that "other independent gas utility companies in the state * * * nevertheless have been able to conduct their operations and, apparently, earn a fair return without the alleged advantages of common control with electric utilities by a holding company."

Taking the record as a whole we find its brief accurate, and that the Commission's interpretation is that a loss is not "substantial" unless it would render impossible "economical or efficient operation."[5]

As to the correctness of this interpretation we have not considered before the meaning of clause (A), and there is no uniformity of judicial view elsewhere. It is true that in *North American Co.* v. *S.E.C.*, 1946, 327 U.S. 686, 696-7, the court referred to section 11(b)(1) as permitting retention only of "relatively small [companies] * * * unable to operate economically under separate management without the loss of substantial economies * * *." This was a passing summary, and did not purport to be an exact characterization. The precise meaning was not

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[5] NEES suggests there is no practical difference between preventing economical operation and bankruptcy. The Commission does not address itself to this question. We assume it believes there to be a difference, but except to the extent suggested in fn. 7, *infra*, we cannot find from its opinion what the difference is, or, more important, what is the standard by which uneconomical operation is determined. The very serious problem which this would present we do not reach because we disagree with the Commission's basic interpretation.

relevant to the constitutional questions then under consideration, and even if the court's language is not considered ambiguous we do not take it as an attempt to resolve possibly intricate questions of construction. We turn, therefore, to other considerations.

Although we do not regard the legislative history as determinative, we begin there as the Commission makes much of it. Its principal reliance is upon the concluding remarks of Senator Wheeler on the floor after the bill had finally passed both branches. Senator Wheeler stated, *inter alia*, that the act permitted a holding company to retain more than one integrated system only when the additional systems "* * * were so small that they were incapable of independent economical operation." 79th Cong. Rec. 14479 (Aug. 24, 1935). We may note, at the outset, that only by a most generous interpretation is this statement part of the legislative history. Having come afterwards, it could not have affected the voting. The best reason for considering it as evidence of Congressional intent, see *United States* v. *United Mine Workers*, 1947, 330 U.S. 258, 279-80; *Duplex Printing Press Co.* v. *Deering*, 1921, 254 U.S. 433, 477; *cf. State Wholesale Grocers* v. *Great Atlantic & Pacific Tea Co.,* D.C.N.D. Ill., 1957, 154 F. Supp. 471, 485, *rev'd on other grounds*, 258 F. 2d 831, *cert. den.* 358 U.S. 947, is accordingly absent.[6] Furthermore, coming from the leading Congressional advocate of strict separation, see *e.g.*, 79 Cong. Rec. 1525, Feb. 6, 1935; *id.*, 4903 (radio address of April 2, 1935); *Id.*, 14470, Aug. 24, 1935 (remarks of Senator

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[6] See Hart and Sacks, The Legal Process: Basic Problems in the Making and Application of Law (tent. ed. 1958) 1285:

"The views of individual members of the legislature as to the meaning of a statute which were not officially communicated to the legislature prior to its enactment are not competent to be considered in determining the meaning which ought to be attributed to the statute."

Nor could it have invited a presidential veto, since the President was a known advocate of a strong bill. See 79 Cong. Rec. 3425-26, 3469-70, March 12, 1935 (Message to Congress); *id.* at 9042, June 11, 1935 (letter to Senator Barkley and Senator Wheeler); *id.* at 14164, Aug. 22, 1935 (letter to Representative Rayburn).

Norris), it would seem natural to regard it, at that stage of the proceedings, as a self-serving declaration. To the cynically minded it would seem to have been merely a post-contest attempt to raise the score, recapture what had been lost in the compromise with the House discussed *infra*, and to serve, just as is now being sought, to influence subsequent history. The best that should be said for Senator Wheeler's statement under these circumstances is that it is not to be given the weight to which it might have been entitled if made at another time.

The other pieces of legislative history related in the Commission's brief are a quotation from remarks by Representative O'Connor speaking "of 'a little power plant in Florida' or 'a little plant in Oklahoma' (79 Cong. Rec. 14168, Aug. 22, 1935)" and one from Representative Cooper, "who had opposed the motion, [and] had referred to systems retainable under Clause (A) as 'unprofitable companies * * * too weak to stand alone' (*id.* at 14165-14166)." Examination of Representative O'Connor's full statement rebuts the economic implication the Commission wishes us to attach to the word "little." It is evident that the remarks were addressed to geographical aspects, the absentee landlordism condemned in clause (B). It is true that Representative Cooper was speaking of clause (A). But it seems apparent that as an opponent of the bill he was strategically engaged in blackening it. According to him the compromise was no compromise whatever, a position demonstrably unsound. His interpretation of particular clauses must be read in that light. *Labor Board* v. *Fruit & Vegetable Packers & Warehousemen, Local No. 760*, 1964, 377 U.S. 58, 66.

A much more pertinent characterization of the phrase "substantial economies" is found in the statement of the House Managers attached to the conference report recommending passage of the compromise draft, that the retention of additional systems was to be permitted where there was a "real economic need." H.R. Rep. No. 1903, 74th Cong., 1st Sess., 71. This language, however, is itself ambiguous. Obviously there would be a real economic need to prevent a loss that would preclude efficient or effective operation. But there could also be said to be a

real economic need to avoid any truly sizable financial loss notwithstanding the utility's ability to absorb it and remain efficient in some absolute sense.[7] For reasons we now come to we believe the statute is to be given this more general meaning.

The declaration of legislative objectives is found in section 1(b). Subsection (1) thereof concerns improper accounting practices, capitalization, etc., that may injure investors. Subsection (2) refers to excessive charges and other effects of transactions among companies within a holding company system. It also, together with subsection (3), refers to impediments occasioned by the holding company device to state regulation. We quote in full the remaining subsections, which declare the public interest to be adversely affected,

> (4) when the growth and extension of holding companies bears no relation to *economy of management and operation* or the integration and coordination of related operating properties; or
>
> (5) when in any other respect there is *lack of economy of management and operation* of public-utility companies *or lack of efficiency and adequacy of service* rendered by such companies, or lack of effective public regulation, or lack of economies in the raising of capital. [Italic supplied.]

Pausing here we note in the italicized phrases two concepts, economy of management and operation, and effi-

[7] We have already commented upon the Commission's failure to enunciate any standard beyond this broad generalization of economy or efficiency. See fn. 5, *supra*. Possibly its views are partly implied by the points made in its opinion when assuming that an annual loss of $1,098,000 had been adequately established. The first was that while this amount is larger, absolutely, than losses required to be accepted in any previous case, it is not larger relatively. Secondly, that the loss would be only 23.28% of gross income, and 29.94% of net income before federal income taxes. (The word "only" is ours.) Third, that there are "other independent gas utility companies in the state which nevertheless have been able to conduct their operations and, apparently, earn a fair return * * * and * * * compete effectively. * * *" Finally, that it "would be entering the realm of speculation at this time to assume that rate increases would ensue from severance."

ciency (and adequacy) of service. The word "or" in clause (5) is clearly used in the disjunctive. This separate meaning is emphasized when we come to section 11 (b) (1) clauses (A) and (C), *infra.* It will be sufficient to note here, for both present and future purposes, that the Commission has taken the word "efficient" from this use in connection with service and joined it with the phrase "economy of management and operation," and has then built out of the combination the concept that until a loss of economy and efficiency is shown to be total there has been no loss of substantial economies under clause (A) within Congressional concern. We may note, also, an omission which we take seriously, that on the sole occasion that the Commission quoted clause (4) it substituted asterisks for the phrase we have italicized, and, although the legislative meaning of economies is the specific matter under consideration, has never referred to it. Clause (5), likewise, is never mentioned.

The definitions of "integrated public-utility systems" are found in section 2(a)(29). Subsection (A) defines an integrated electric system as one which, *inter alia,* "may be economically operated as a single interconnected and coordinated system." Subsection (B) defines a gas system as where, *inter alia,* "substantial economies may be effectuated by being operated as a single coordinated system." During argument we inquired the reason for this difference. No suggestion was forthcoming. The only reason apparent to us is that in order for electric companies to constitute an integrated public utility system they must meet a technical requirement not applicable to gas companies seeking to qualify as an integrated system. Unlike gas companies, *General Pub. Util. Corp.,* 1951, 32 S.E.C. 807, 834-35, electric companies must be "physically interconnected or capable of physical interconnection." Where this requirement is met, so that actual interchanges of power could be made to meet power requirements at different points in the system, it was enough for Congress that the system as a whole "may be economically operated as a single interconnected and coordinated system." Assuming the other qualifications were met electric companies would not have to prove that

system ownership would be cheaper than independent ownership, probably because this could safely be assumed where there would be a sharing of power.

Coming to section 11(b), the primary provision, subsection (1) requires that holding companies be restricted to a single integrated public utility system except when subclauses (A), (B) and (C) are satisfied. For clarity we quote in full.

> (A) Each of such additional systems cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system;
>
> (B) All of such additional systems are located in one State, or in adjoining States, or in a contiguous foreign country; and
>
> (C) The continued combination of such systems under the control of such holding company is not so large (considering the state of the art and the area or region affected) as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation.

These exceptions to section 11(b)(1) were added as a result of a compromise with the House. The original Senate bill had flatly restricted holding companies to a single integrated system. S. 2796, 74th Cong., 1st Sess. (1935). The House sought to permit as many systems as were consistent with the public interest. See H.R. Rep. No. 1318, 74th Cong., 1st Sess. 17 (1935). The Commission's then chairman objected that this would be intolerably indefinite. 79 Cong. Rec. 10838 (July 9, 1935); see also H.R. Rep. No. 1318, *supra*, at 45. Clauses (A), (B) and (C) were proposed as a compromise to establish "definite and concrete circumstances" where retention of more than one system would be allowed. Statement of House Managers, *supra*, at 70.

It is basic to the Commission's position that the phrase "substantitl economies which can be secured by the retention of control" in clause (A) is fundamentally different from "substantial economies [that] may be effectuated

by being operated as a single co-ordinated system" in section (29) (B).[8] Such a contention, of course, is opposed to the common principle that the same words in different portions of an act are presumed to have the same meaning. In this case they are exactly the same.[9] To overcome the presumption calls for an affirmative showing.[10]

Furthermore, we find the Commission's interpretation of clause (A) opposed to the initial statement of the purposes of the Act, *supra*, the tenor of which was that holding companies had been found uneconomical to investors and to the public. It is not inconsistent with this to say that systems which do not offend in this respect, or in the other respects defined in clauses (B) and (C), should be continued instead of broken up, and that occasioning a loss of impressive proven economies was not the Congressional purpose. This was a business reorganization act designed to produce a healthier economic structure

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[8] The Commission is committed to this, and expressly so recognizes in its brief, because it rejected certain important evidence offered by NEES solely on the ground that the eight gas companies were conceded to be "a single integrated system." Since the Commission could not, either in good conscience or in law, accept as a concession a matter so fundamental, not only to the present proceedings, but for the future, if it were contrary to the fact, it stands that the Commission feels that saving $329,400 annually by integrating the eight gas companies is effectuating substantial economies under section (29)(B), but that $1,098,600 annually is not substantial economies under clause (A).

[9] The Commission's brief goes to some length in emphasizing the word "loss" in section 11(b)(1)(A). Sections 2(a)(29)(B) and 11(b)(1)(A) are not incomparable because the former speaks in terms of effectuating and the latter in terms of losing. The important comparison is the word "effectuated" in the one section and "secured" in the other. Both relate directly to "substantial economies."

[10] In a special effort to make this showing counsel argues that there is a policy in the Act against an electric utility system being combined with a gas system. The short answer to this is that neither the Act, nor the Commission itself, says so. Since, however, counsel's argument is extensive we will reply in kind, but in order not to prolong this footnote we will do so in an appendix, *infra*.

in a vital industry. It established what, in the opinion of Congress, accomplished the best overall conditions. At the same time, Congress remained receptive to what, in a particular instance and within the limits established by clauses (B) and (C), might be affirmatively shown to be a more economical arrangement. We hold that clause (A) called for a business judgment of what would be a significant loss, not for a finding of total loss of economy or efficiency. *Louisiana Pub. Serv. Comm'n v. S.E.C.*, 5 Cir., 1956, 235 F.2d 167, *rev'd on jurisdictional grounds*, 353 U.S. 368.

We are confirmed in this view by the fact that not only do clauses (B) and (C) contain additional conditions of retention, so that clause (A) need not be interpreted so as to cover the entire Congressional intent, but that these other clauses relate back fully to counterparts of the declarations of purpose made in section 1(b), and the attempts to effectuate those purposes through the definitions made in section 2(a)(29), *supra*. Clause (A) would do the same were it not for the special restricted meaning that the Commission seeks to give it. The Commission, in other words, has attached to "substantial economies" in this one particular place a special meaning that nothing in the Act points to, and which, in fact, destroys its symmetry.[11]

It might not be inappropriate to conclude with the quotation with which the Commission began a section of its brief. "As was stated [the brief says] in the report of the National Power Policy Committee: '[I]ntensification of economic power beyond the point of proved economies not only is susceptible of grave abuse but is a form of private socialism inimical to the functioning of demo-

[11] Drawing an equivalence between the proviso contained in clause (A) to section 11 and the corresponding requirements for an integrated gas system under section 2(a)(29)(B) nullifies no technical requirements in the definition of an integrated gas system because there are none. The definition of an integrated electric system under section 2(a)(29)(A) does contain some technical requirements, as has been pointed out, but these, also are not nullified by our interpretation of clause (A) since it remains stricter than section 2(a)(29)(A)'s requirement that the electric system "may be economically operated."

cratic institutions and the welfare of a free people.' * * * H. Doc. No. 137, 74th Cong., 1st Sess. 4 (1935), appended to S. Rep. No. 621, 74th Cong. 1st Sess." We cannot think that "proved economies," any more than "substantial economies," mean anything other than economies which in ordinary business parlance and by ordinary business standards are of a substantial nature, considering, of course, the size of the companies to which the economies relate.[12] Clearly that was what was meant elsewhere in the Act. If in clause (A) Congress meant, instead, "cannot be operated efficiently as an independent system" it could readily have done so not only more clearly, but in fewer words.

Te Commission's only answer is "the policy of the Act." We think the policy of the Act is to be found in the whole Act, not in one part. NEES has the burden of proving that it falls within an exception. This is enough, without a forced reading into that exception of some special meaning.

We regret the length of this discussion. Since, however, we find the Act not only consistent, but entirely responsive to analysis, we feel such analysis called for in fairness to those persons, whether investors or consumers,[13] who must absorb perhaps a million dollars a year (quite apart from over $800,000 allegedly lost to the electric system) which the Commission feels insubstantial.

The Commission having applied the wrong standard, its decision must be reversed unless on the record there could have been no finding in NEES' favor on the appropriate standard. We think clearly there could have been. NEES' case was based essentially upon a study made for it by Ebasco Services, Inc., (Ebasco), a man-

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[12] In this case the claimed losses are over 23% of gross income. See fn. 7, *supra*.

[13] The Commission's finding it significant that it was insufficiently shown that this loss would require an increase in rates "at this time," fn. 7, *supra*, not only disregards the fact that the cost of doing a utility business normally is passed on to consumers eventually, but the fact that one of the purposes of the Act was to benefit legitimate investors.

agement consultant which the Commission found possessed extensive experience in the utilities field. No rebuttal evidence, other than some exhibits, was offered on behalf of the Commission, which grounded its rejection of the report, to the extent that it did reject it, solely on criticism of the report's conclusions in the light of NEES' evidence or its own expertise. Its specific criticisms related to that portion of the report which dealt with certain costs totalling $472,100 or, more specifically, for the most part, customer and accounting costs included therein, for which the Ebasco estimate was $415,600. The first criticism concerned billing. The circumstances were these. Ebasco's original study was made on the assumption that the gas companies would be individually managed. On this hypothesis it naturally assumed that each company would conduct separate customer billing. When the Commission took the position that the gas companies constituted a single integrated system and should be sold as such, Ebasco was required to reduce its estimate by the amount attributable to operating the gas companies individually rather than as a unit. It made no reduction with respect to customer billing.

On this subject NEES called three witnesses. One Quig, a representative of Ebasco with ample qualifications, testified to certain accounting savings that could be effected if the gas companies were operated collectively rather than individually. He stated, however, that Ebasco would not recommend, at least at the outset, centralization of certain matters, including billing; that a continuing study might show that further centralization would prove useful, but that it was by no means clear that economy lay in that direction, and that it would depend on such factors as business growth, new developments in mechanization, etc. Subsequently one Dalbeck, the principal officer of NEES' gas division, testified that it was conceivable that centralized billing might be effected to some degree, but that in his opinion it was not really important cost-wise; that he had made many studies of customer accounting procedures and had never found any real economies in centralization of billing. Thereafter one Johnson, an Ebasco representative with particular experi-

ence in customer accounting, testified that a detailed study would have to be made, which Ebasco had not done; that based upon his experience he had considered centralized billing for the combined operation and had made the judgment that there would be no economy, or at least "any substantial savings." The witness was cross-examined at length and showed a wide knowledge not only of specialized mechanical equipment in this area and the problems involved, but also of the particular practices of a large number of named utilities in various parts of the country. He recognized that in many instances centralized billing prevailed, but continued to express doubts as to how much was saved thereby.

The Commission's response to this was to point out that some of the NEES gas companies presently combined their billing with the electric companies in their areas. This matter had been explained by NEES' witnesses, who pointed out, *inter alia,* the duplication of customers, which would not exist in the case of gas companies operating alone. The Commission concluded, however, that NEES had not "given any satisfactory reason why at least some form or forms of combined billing procedure could not be employed advantageously by the gas companies, in light of the fact that their aggregate of 237,000 customers is located in a relatively compact area."

We have serious doubts as to the extent that the Commission is entitled to disregard an opinion on a matter obviously requiring expert, specialized knowledge with no further evidence before it than what had been considered by the accepted expert. *Cf. United Shoe Mach. Corp.* v. *Industrial Shoe Mach. Corp.,* 1 Cir., 1964, 335 F. 2d 577, 579, *cert. den.* 379 U.S. 990; *Security-First National Bank* v. *Lutz,* 9 Cir., 1963, 322 F. 2d 348, 355; *Alvary* v. *United States,* 2 Cir., 1962, 302 F. 2d 790, 794; *Cullers* v. *Commissioner,* 8 Cir., 1956, 237 F. 2d 611, 616. This is not a matter on which a body having such broad jurisdiction as the Commission can have detailed expertise upon which to base affirmative findings. Compare *Market St. Ry.* v. *Railroad Commission,* 1945, 324 U.S. 548, 560. Without finally passing upon this point, since the case must go back in any event, we suggest that on this record

the maximum the Commission was warranted in inferring was that the difference in costs between separate and combined billing would not, if significant at all, constitute a sizable portion of the total added billing expense.

This brings us to what was the added billing expense, and hence the amount of error attributed to the Ebasco report because of its failure to assert the saving which, in the Commission's opinion, could be effected by having centralized billing. The Commission concluded merely that Ebasco's failure caused the estimate to be "overstated." It did not concern itself with discovering even what were the total increased billing costs, let alone the portion (obviously not the whole) which might be saved if centralized billing were adopted. It did find that the increased billing costs estimated for two of the eight gas companies, billing singly after divestiture, was \$34,700 for the two. These companies covered more than half of NEES' gas customers. On a pro rata basis this would make the total billing increase for all companies \$60,000. While doubtless such a projection is not precise, it seems significant that the Commission was not sufficiently interested to make any at all. Under the circumstances we do not think it unreasonable for us to point out that while the Commission was purportedly criticizing a cost estimate of over \$400,000, strictly it was speaking of perhaps \$60,000, only a portion of which could have been overstated.

We might have more sympathy with some, but not all, of the Commission's criticism of certain other alleged accounting disparities. Frankly, we are not sufficiently versed, nor do we find the record sufficiently helpful, to permit our analyzing them in every detail. However, it has not been contended that, even cumulatively, they remove from the Ebasco \$472,000 cost estimate many sizable items.

After discussing the above matters the Commission said,

> In view of respondent's burden of proof and the absence of a persuasive explanation on the record, Ebasco's failure to consider employment of combined

> billing procedures and its inadequately explained disparate treatment of certain effects of severance on the gas and electric companies, respective, substantially impair the credibility and preclude the acceptance of its estimate of $472,100 increase in treasury and accounting costs and, in turn, of its over-all estimate of increased costs (of which that figure is a material part) in the determination of whether severance would result in a substantial loss of economies.

If this constitutes a finding that the deficiencies which the Commission believes it has found are so serious that the Commission was entitled to reject the balance of the report from that very fact, we cannot agree. The doctrine of "*falsus in uno, falsus in omnibus*," so far as it has any value, ordinarily applies to cases of deliberate falsehood. See 3 Wigmore, Evidence § 1013 (3d ed. 1940). The Commission has not suggested, and we see no possible basis for suggesting, that the discrepancies it complains of indicate bias or dishonesty. Absent a finding that the errors found are related to, or infect, other matters not directly discredited, if the "*falsus in uno*" doctrine, or a corollary, is to be used on any further basis to impeach an expert's report, it must be shown that the errors are so serious that they indicate substantial carelessness, or otherwise impugn the expert's qualifications. See *e.g.*, *Hoag* v. *Wright*, 1903, 174 N.Y. 36, 43; 66 N.E. 579, 581. Again, the Commission made no such findings. If there was a ground for them it has not been suggested. Indeed, the Commission demonstrated its confidence in Ebasco elsewhere by accepting its cost estimates as the basis for concluding that the gas companies constitute an integrated system.

On the record there is a large, residual showing in the Ebasco report. Even at minimum it is $1,098,000 minus some fraction of $472,000. However, we do not think it presently appropriate for us to consider whether such minimum showing meets our interpretation of "substantial economies." We do state, however, that on remand the Commission must address itself to this problem by

making specific findings, and not content itself with general conclusions. One illustration of this will suffice. The Commission states in its brief that it "had the right to consider competitive advantages of separation in offsetting alleged losses of economies." We do not question this. What we do question is the Commission's failure to find or articulate any specific or approximate financial benefit that such a change would occasion. Free competition, as the Act recognizes is normally beneficial. It is not necessarily so, nor in any assumed amount. The various automotive divisions of General Motors seem to do very well. More close to home, the Massachusetts Department of Public Utilities, which voices no apparent criticism of a number of combined local gas and electric companies within the Commonwealth, affirmatively appeared in opposition to the Commission's proceeding in the present case. The Commission states that the Department's views have been "carefully considered," but it goes no further. If the Commission is of opinion that substantial gains will accrue to the gas system by placing it in competition with the electric companies rather than, in part, under the same roof, specific findings should be made, and not just a general reference to the advantages of competition. This is particularly called for where the evidence shows that NEES has made a special effort to obtain for its gas system many of the benefits of independence.

*Decree will be entered vacating the order of the Commission and remanding for further action not inconsistent herewith.*

## APPENDIX

In the Commission's brief counsel argues that section 11(b) embodies a federal concern with use of the holding company form to combine a gas system with an electric system. There are several answers to this. In the first place, it is too specialized an approach. The meaning of this section and of sub-clauses (A), (B) and (C) must be the same whether the principal system and the additional systems are of like nature or are different. "Substantial economies," in other words, should have the same connotation in the one case as in the other.

Secondly, nowhere in the Act is there a condemnation of the retention of gas and electric systems, provided the tests contained in clauses (A), (B) and (C) are met. To the contrary, section 8 prohibits a holding company's acquisition of gas and electric utilities serving the same territory, where state law prohibits combined gas and electric operations, without express approval of the state commission. If anything, this is a negative pregnant, as the Commission has recognized and the legislative history makes clear. See *Northern States Power Co.*, 1954, 36 S.E.C. 1, 8; S. Rep. No. 621, 74th Cong., 1st Sess., 29-30; H.R. Rep. No. 1318, *supra*, at 14-15; Report of National Power Policy Committee, H.R. Doc. No. 137, 74th Cong., 1st Sess. 10 (1935), appended to S. Rep. No. 621, *supra*, at 59; Hearings Before House Committee on Interstate and Foreign Commerce on H.R. 5423. 74th Cong., 1st Sess. 330 (1935) (statement of Rep. Rayburn). How far such an inference may be carried in the light of the fact that section 10(c), which prescribes the standards for acquisitions, expressly incorporates the retention standards, and requires further that an acquisition tend toward the development of an integrated system, may be questioned. *Cf. American Water Works & Elec. Co.*, 1937, 2 S.E.C. 972, 983 & n. 3; *Columbia Gas & Elec. Corp.*, 1941, 8 S.E.C. 443, 462-63; *American Gas & Elec. Co.*, 1946, 22 S.E.C. 808, 815. But at the least we find neither there nor elsewhere in the Act a general policy of opposition to gas and electric company joinder.

Nor, if the matter could be thought to be illuminated by administrative practice, has the Commission previously

made such an interpretation, nor does it now. In its opinion the Commission stated, "We do not take the view that the Act expresses a federal policy against combined gas and electric operations as such." Counsel's attempt to explain this away by saying the Commission's phrase "as such" meant simply that the Commission was disclaiming interest when the interstate holding company form was not employed, attributes to the Commission the banality that it was not claiming jurisdiction in those cases where obviously it does not have it. We believe the Commission was saying something more than this, and that counsel, in the brief is merely seeking some new ground to support the Commission's result.

## OPINION AND JUDGMENT BELOW

March 31, 1967

COFFIN, *Circuit Judge.* This petition for review of a Securities and Exchange Commission order is before us for a second time, on remand from the Supreme Court. The petitioner, New England Electric System (NEES), is a registered holding company controlling fourteen electric utility and eight gas utility companies in the New England states. In August 1957 the Commission instituted proceedings to determine whether NEES was entitled to retain that control under the standards of section 11 (b) (1) of the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79k(b) (1). Extensive hearings, resulting in a record of nearly 1,500 pages, culminated in the Commission's order of March 19, 1964, requiring NEES to divest itself of all its gas companies.

In our earlier opinion, as here, we focused primarily on the Commission's application to the NEES system of the "substantial economies" test of section 11(b) (1) (A), 15 U.S.C. § 79k(b) (1) (A). Generally, section 11(b) (1) allows a holding company to control only one system of operating utility companies. However, control of an additional integrated public utility system[1] is permitted if, in addition to size and location requirements not here in dispute, the Commission finds that the system "cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control" by the holding company.

We held that the statutory words, "loss of substantial economies", called for "a business judgment of what would be a significant loss, not for a finding of total loss of economy or efficiency". *New England Elec. System* v.

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[1] As applied to gas companies, an integrated public utility system is "a system consisting of one or more gas utility companies which are so located and related that substantial economies may be effecuated by being operated as a single coordinated system confined in its operations to a single area or region . . . ." 15 U.S.C. § 79b(a) (29)(B). The Commission held, and it is assumed here, that the eight gas companies constitute such a system.

*SEC*, 1 Cir., 1965, 346 F.2d 399, 406. Since we read the Commission's opinion as holding incorrectly that lost economies would not be substantial unless divestment would render "economical or efficient operation" imposssible, and since we believed that under the appropriate standard the Commission could have found for NEES on the record before it, we ordered the case remanded. The Supreme Court reversed, holding that the Commission's interpretation of the statute was correct, and remanded the case to us for review of the Commission's order in light of the proper meaning of the statutory term. *SEC* v. *New England Elec. System*, 1966, 384 U.S. 176.

In approving the Commission's interpretation of section 11(b)(1)(A), the Court said that it required a showing that the "additional system cannot be operated under separate ownership without the loss of economies so important as to cause a serious impairment of that system." 384 U.S. at 179. In illustration the Court quoted the language of the House report, that there must be a showing of "a real economic need"; of Senator Wheeler, speaking after the bill was passed, that the exception would apply only to systems "so small that they were incapable of independent operation"; and of the Commission itself, in *Philadelphia Co.*, 1948, 28 S.E.C. 35, 46, that there must be a "situation in which the proven inability of the system to stand by itself would result in substantial hardship to investors and consumers were its relationship with the holding company terminated." Finally, the Court concluded (1) that the proper test was "much more stringent" than a business judgment of significant loss; (2) that while economy in management was one theme of the act, eliminating restraint of free competition was another; and (3) that offsetting gains to competition, difficult to forecast, were "a matter for Commission *expertise* on the total competitive situation, not merely on a prediction whether, for example, a gas company in a holding company system may make more for investors than a gas company converted into an independent regime." 384 U.S. at 185.

The only area remaining for definitional dispute is whether the holding company, to justify retention, must

prove that severance will result in imminent bankruptcy of the subsidiary, or something less—a condition allowing survival but not on a sound or "healthful continuing" basis, *Engineers Pub. Serv. Co.* v. *SEC*, D.C. Cir., 1943, 138 F.2d 936, 944. We think the answer lies in the latter definition. This, we think, stems from a careful reading of the Court's opinion, particularly in the light of the Commission's opinion which it was interpreting.

We have taken pains to summarize the sequence of quotations cited by the Court, all of which have been relied on by the Commission, because, while they are internally consistent in militating against a test of business judgment of probable significant loss, they suggest that the Commission has not always been clear as to whether it considers "serious impairment" or "inability to survive" the standard. The first two quotations are consistent with the former; the last two, with the latter.

That the Court's use of the "serious impairment" language reflected the fair import of the Commission's opinion is clear. That opinion contained only one reference—to Senator Wheeler's language above quoted—consistent with an "inability to survive" test. Its remaining verbalizations were "real economic need" (House Report language above quoted); "ability of the additional system to operate soundly" (Commission's own formulation); "important economies" (*North American Co.* v. *SEC*, 2 Cir., 1943, 133 F.2d 148, 152) related to "the healthful continuing business and service of the freed utility" (*Engineers Pub. Ser. Co.* v. *SEC*, *supra*); and the conclusion of the Commission in its own words that "a registrant seeking to retain an additional system has the burden of showing . . . that such additional system cannot be operated under separate ownership without the loss of economies so important as to cause a serious impairment of that system." The Court, therefore, advisedly chose this language as "the Commission's reading of Clause (A)".

We also observe that if Congress had meant to allow retention only when the alternative was extinction, the test of section 11(b)(1)(A) could have been shortened to require a finding that the subsidiary "cannot be operated as an independent system." Furthermore, the

Court's emphasis on the likelihood of offsetting gains to competition presupposes the continued operation of the gas companies—we cannot imagine that competition would gain from the elimination of competitors. Finally, it is as impossible to say that "serious impairment" of an additional utilities system means "inability to survive" as to say that "serious injury" means "death."

We take the trouble to distinguish between these two remaining possible approaches because of hints in the Commission's supplemental brief, signed by its General Counsel and argued by its Solicitor, that it sees the test in terms of likely death of a system if divestment is ordered. This brief articulated the "Question Involved" as follows:

> "[T]he only question remaining for this Court's consideration is whether the Commission correctly held that petitioners failed to sustain their *burden of proof that NEES integrated gas utility system was unable to stand by itself so that substantial hardship to that system's investors and consumers would result from a termination of its relationship with NEES*."
>
> (Emphasis added.)

This manner of stating the question ignores the "serious impairment" language to which the Court gave first attention in its opinion, but draws exclusively from the language quoted from *Philadelphia Co., supra*. The Commission's wording of the "Question" also makes it clear that a system's inability "to stand by itself" is the event bringing about the "substantial hardship" to investors and consumers. This reading of the test is made more clear by the brief's truncated quotation of *Philadelphia Co.* in saying that that case places "upon petitioners the burden of proving the 'inability of the additional system to stand by itself.'" The significance of hardship to investors and consumers is ignored. As final corroboration, it is to be noted that this abbreviated quotation from *Philadelphia Co.* is immediately followed by the statement, "in the light of this test . . . . there is no basis for petitioner's arguments that [the statute means] 'such

loss [as] would impair the gas companies' ability to compete effectively . . . .' "

It seems too probable to us, therefore that the Commission, at least in its supplemental brief, now views the statute as requiring divestment unless petitioners can prove that they could not operate as an independent system. Such a test would, we think, read out of the statute the phrase "without the loss of substantial economies" and would distort the Court's imprimatur on the words "serious impairment".

Even without the burden of proving likely demise, petitioner's burden is, as the Court said, to meet "a much more stringent test" than that of a probable significant loss. But, if the standard to be applied to petitioner is stringent, so is the level of analysis and expertise to be exercised by the Commission. We have, only after a fresh review of all the evidence in the light of this *most stringent* practical standard, concluded that the Commission's opinion does not reveal that application of both reason and experience to facts which merits endorsement as the responsible exercise of expertise.

To make intelligible our difficulties it is necessary to review again the basic facts in evidence and the Commission's express bases for decision. The eight gas companies involved are operated under the general control of the NEES Gas Division, whose officers are responsible directly to the general offcers of the holding company and have no duties regarding the electric companies. Seven of the eight operate in areas overlapping the service areas of one or more NEES electric companies and share some facilities, such as office space, meter readers, and accounting personnel and equipment. Both the gas and the electric companies obtain services such as supervision of accounting, purchasing, insurance, legal counsel, labor relations administration, and handling of rate matters from the New England Power Service Corporation, another subsidiary of NEES. In most other respects the gas companies are operated as an independent system, in competition with NEES and other electric companies and with numerous unregulated oil companies.

To support retention, NEES offered the report of a study by a professional utility engineering and consulting

firm, Ebasco Services, Inc. (Ebasco), projecting the results of severance on the gas companies, in terms of increased cost of operations. The report presented a detailed description of the organization and operation of the gas companies as of 1958-1959 and as projected after severance, with an estimate of the actual and pro forma costs assigned to each phase of the operations. It concluded that severance would result in recurring additional costs of $1,495,000 per year, on the assumption that the gas subsidiaries would be operated at eight wholly independent companies. A supplemental report reduced the figure to $1,098,600, on the assumption adopted by the Commission that the companies would be operated as a single integrated system.[2] The increase represented primarily the increased cost of the personnel repuired to duplicate the essential functions now being performed by the service company, and the loss of economies of scale now obtained by joint operation with the electric companies. The latter category included the increase in the cost of customer accounting, the loss of quantity discounts in purchasing, and the substantially increased cost of obtaining insurance against disaster losses.

The Commission rejected the Ebasco report's conclusion, on the grounds (a) that the supplemental report and the witnesses did not satisfactorily explain why the cost of customer billing could not be reduced by using a centralized system for all eight companies, rather than individual billing by each company; (b) that the report projected greater increases in the per-customer costs of customer accounting to some gas companies than to the NEES electric companies sharing the same facilities, without satisfactory explanation; (c) that, since the increased cost attributed to customer accounting ($472,100) constituted a large part of the total increase claimed, NEES's failure to justify the whole of that item "substantially impaired" the credibility of the entire estimate; and (d) that the estimated additional salaries and/or posi-

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[2] The latter figure also reflects a reduction of $67,000 to account for a Commission-approved increase in Service Company charges to the gas companies that took effect after 1959.

tions for the top executive staff of the gas system were also suspect.

Nothing in the Court's opinion causes us to change our views on this issue as expressed in 346 F.2d at 407-09.[3] We do not necessarily criticize the Commission for its skepticism in the specifics; but we do think that even taken together these items constitute at most a basis for reducing the estimated figure by some amount, not for concluding that no increased costs have been proved. In fact, the record here demonstrates conclusively that *some* increased costs are inevitable—the only doubt possible concerns the amount. Furthermore, we think that if the Commission is to use its expertise to assess the impact of the costs in "the total competitive situation", it must attempt to determine some acceptable figure as a predicate for its assessment. Since, however, the Commission here proceeded on the alternative ground that the full amount of the Ebasco loss estimate ($1,098,600) was proven, we pass further discussion of the amount of losses and turn to their impact.

On this issue, NEES presented evidence that, because of their position at the end of the pipelines, the high cost of manufacturing gas locally, and the absence of storage facilities, the gas companies of New England pay the highest price in the country for the gas they sell, and consequently enjoy little or no price advantage over oil in the important house heating market. Electricity is competitive, apparently, only in a quality market, but has shown better progress than expected. The growth of gas sales in New England, while showing a high percentage increase from a very low base, has lagged substantially behind the rest of the country in saturation of the mar-

[3] The Commission made another error, which we pointed out in our previous opinion, 346 F.2d at 401 n.4, namely, the imposition of too heavy a standard of proof. The Commission persists in saying that "by clear and convincing evidence" means the same thing as "by a fair preponderance of the evidence." With the exception of one court of appeals decision, which we stated before we would not follow, all courts that we know of consistently recognize what to us seems self-apparent, that there is a significant difference. McCormick, Evidence (1954) ch. 36, § 320. For a recent observation on this subject, see *Woodby* v. *INS*, 1966, 385 U.S. 276.

ket. Evidence was offered that, although the NEES gas companies have shown a higher rate of growth, of revenues, of increase in saturation, of earnings, and of return on sales expenses, and lower operating expenses than other gas companies in Massachusetts, they have also shown a lower sales revenue per customer. NEES officers and representatives of the Massachusetts Department of Public Utilities testified that the NEES companies operate in areas of slow population growth, as compared to other companies in the state.

To this the Commission responded (a) that as to the geographical disadvantage of operating in New England, the NEES gas companies were in no worse position that the non-affiliated Massachusetts companies which have "apparently" been able to earn a fair return; (b) that the NEES companies, being the second largest gas utility operation in Massachusetts, should be able to provide itself with management comparable to the others'; (c) that the NEES gas companies' operating ratio [4] of 76.41 per cent would compare favorably to others in the area; (d) that there was no "specific demonstration" of a causal relation between population growth and gas sales; (e) that the projected losses, even if assumed to be proved, were not substantial within the meaning of section 11 (b) (1) (A), because the ratios of the losses to revenues (4.83 per cent), to operating expenses (6.03 per cent), to gross income (23.28 per cent), and to net income (29.94 per cent)—"the test of substantiality of the estimated loss"—were lower or not substantially higher than similar ratios in prior cases where divestment had been ordered; and (f) that in any event, despite the relatively independent operation of the gas subsidiaries, the operation did not secure the competitive advantages obtainable from single-minded independent management.

We have taken the trouble of including all of the Commission's expressed bases for decision because of our conviction that they do not communicate to us the application of agency expertise in this critical area. For it is here

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[4] "Operating ratio" is defined as the percentage of total operating deductions (excluding depreciation, amortization of conversion costs, and federal income taxes) to total operating revenues.

that the delicate judgments—informed by experience, sharpened by close analysis, and ripened into the soundest possible intuition about what is likely to happen—that we call expertise, come into play. Cost accountants, efficiency experts, and engineers can arrive at figures for the likely increases of costs. But a wider-ranging inquiry must be made to arrive at an educated guess whether the increased burden, falling on a company in the economic and competitive situation of the gas companies involved here, will amount to substantial lost economies—whether its effect will be undue harm to the companies' investors and customers. The importance of care and discrimination in the conduct of this inquiry is underscored by the Supreme Court's clarification of the statutory standard. That the line of "serious impairment" is drawn so close to the point of probable business failure makes the holding company's burden of proof more difficult to carry; but it also makes the risk more substatial that a divestment order based on erroneous findings will result in economic disaster.

With this in mind, we must conclude that the Commission's analysis in the present case does not adequately address the considerations relevant to the ultimate issue it is required to resolve. To be sure, the evidence summarized above is far from conclusive; and it cannot be denied that there are imponderable factors. At the time of the hearing, the gas companies in New England were considering several ways of reducing their basic costs, such as development of local storage areas, construction of a plant to manufacture liquefied natural gas, and importation of gas by ocean tanker. At the same time they feared that existing oil import restrictions might be loosened. It may be that in the intervening years some of these possibilities have ripened to change the basic competitive circumstances. Nevertheless, we can only conclude on the present record that all gas in New England operates on, as one witness testified, a small cushion. The significance of this is not negated by observing that non-NEES companies in Massachusetts seem to be surviving, for the focus must be on the specific characteristics of the NEES companies, the only ones affected by the Com-

mission's order. Similarly, that the NEES gas companies together would be the second largest system in Massachusetts is a descriptive, not an analytical proposition. It offers little help in assessing ability to survive. Indeed, the record here is silent on the economic health of the largest system.

A more precise basis for the Commission's decision lies in its use of ratios of the estimated losses to revenues, expenses, and income, in comparison with those adduced from previous divestment cases. The use of these ratios as a test is posited on the undeniable observation that, "in the context of clause (A), the 'substantiality' of asserted losses of economies cannot be tested in absolute terms but rather must be evaluated in relation to total revenues, expenses and income." *Philadelphia Co.*, 1948, 28 S.E.C. 35, 48-49, *aff'd*, D.C. Cir., 1949, 177 F.2d 720. But we observe further that, where the statutory test of substantiality is understood in terms of potential harm to the investor and consumer, even these ratios are significant only as they affect the investment structure of the companies in the particular case, and different companies may be compared only on the assumption that both operate at the same level.

For example, suppose two utility companies, one earning a rate of 6 per cent return on its investment and the other a rate of 5 per cent,[5] both suffer losses amounting to 15 per cent of net income. The result would be to reduce the rates of return to 5.1 per cent and 4.25 per cent respectively. It is entirely possible that the former company would be able to maintain its investment position and operate without a rate increase, while the latter would be unable to produce what would be considered a fair return. In fact, in the present case the projected loss to the NEES gas companies amounted to 30 per cent of net income. At the hearing the Commission staff adduced evidence showing that this loss would de-

[5] Rate of return is defined as the percentage of net operating income to the rate base, which is fixed by a rather complicated formula tied generally to the value of capital assets. It may be noted that where only the percentage change is being considered, the amount of the rate base is irrelevant.

crease the companies' rate of return from 6.4 per cent in 1959 to *4.1 per cent* on the projected basis. This may be compared with an average rate of 5.9 per cent for the non-affiliated Massachusetts gas companies, and is below the minimum of 4.5 per cent. Yet, despite the staff's initiative in securing this obviously important data, the Commission failed even to discuss it, except to observe that "apparently" the non-affiliated companies were earning a fair return. We cannot assume, without reason, that a projected rate of return for the NEES companies which is 30 per cent below the average for their counterparts is irrelevant to the issue of "serious economic impairment".

Nor is it sufficient that the loss ratios considered here are "not significantly higher" than the corresponding ratios of companies ordered divested in previous cases. It is obvious from our discussion above that, even if the companies compared were operating at the same level before divestment, the point must come where a small increase in the percentage loss of income crosses the line between a fair return on investment and one so low as to trigger disinvestment or require rate increases. Moreover, where that line is drawn must depend, among other things, on the market position of the company involved. Comparison with figures derived from the situations of other companies in other places at other times cannot be conclusive.[6]

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[6] The same reasoning makes irrelevant the comparison of operating ratios, since a business may operate relatively efficiently, yet at a level too low to attract investors.

The comparison-of-ratios test first acquired the status of "the test of substantially of the claimed losses" in *Philadelphia Co.*, 1948, 28 S.E.C. 35, *aff'd*, D.C. Cir., 1949, 177 F.2d 720, where it was explained as "nothing more than the normal decisional technique of referring to and comparing the facts in prior decisions as a guide in adjudicating the pending case". 28 S.E.C. at 50 n.24. The validity of this technique presupposes that the facts selected for comparison were significant factors in the prior decisions. But it appears to us that the figures selected for use in *Philadelphia Co.* were either ignored or considered mere makeweights in the earlier cases, except in a few where the percentages were so small as to demonstrate that the claimed losses were *de minimis*. The basis for our conclusion is outlined in the Appendix to this opinion.

In short, we think the standard of "substantial economies", developed by the Commission itself and affirmed by the Supreme Court in this case, requires the Commission—having established its best estimate of the extent of the definable losses likely to result from severance—to address itself to a prediction of the effect of those losses on the economic health of the particular companies involved, in their particular circumstances. Without pretending to define the one true test, we think it clear that relevant factors might include whether the effect of the loss will be (a) to make new equity financing only difficult, or impossible; (b) to reduce the rate of return on investment only slightly, or enough to provoke either disinvestment or a rate increase; (c) to raise the cost of borrowing money a little, or a lot; (d) if rate increases seem probable, to injure deeply, hurt slightly, or affect not at all the companies' ability to survive. The Commission considered none of these.

We recognize, of course, that the selection of relevant factors is for the Commission's determination in the first instance, in the exercise of its expertise. But this principle does not isolate the Commission's conclusions from review to determine whether that expertise has been exercised, and, if exercised, communicated. We do not think that the Commission's obligation, which is at the root of the respect to which its expertise is entitled, is satisfied by the invocation of largely irrelevant ratios or of other data concerning other companies, at other times, in other areas, facing possibly different conditions. Were such ratios sufficient, the resolution of divestment cases could be as well entrusted to electric desk calculators as to an expert administrative agency.

Finally, the Commission attributed some significance in this case to its doubt that "such a separation of the gas from the electric operations has been effected as to secure the kind of single-minded management for each that would obtain upon actual divestment." This conclusion was supported by the observation that other Massachusetts companies had been "more effective" in their operations, and by language best considered in the context of its quotation by the Supreme Court:

"In the present case the Commission said on this phrase of the controversy:

> 'Although the NEES Gas Division handles sales and promotional activities and various other matters for the gas subsidiaries separately from the electric companies, final authority on all important matters rests in the top NEES management. The basic competitive position that exists between gas and electric utility service within the some locality is affected by such vital management decisions as the amount of funds to be raised or allocated to the expansion or promotion of each type of service.'

"Competitive advantages to be gained by a separation are difficult to forecast. The gains to competition might well be in the public interest and might well offset the estimated loss in economies of operation resulting from a separation of the gas properties from the utility system. This is a matter for Commission *expertise* on the total competitive situation, not merely on a prediction whether, for example, a gas company in a holding company system may make more for investors than a gas company converted into an independent regime.

"The phrase 'without the loss of substantial economies' is admittedly not crystal clear. But the Commission's construction seems to us to be well within the permissible range given to those who are charged with the task of giving an intricate statutory scheme practical sense and application." 348 U.S. at 184-85.

We have quoted at such length because we think it important to understand precisely the meaning of this part of the Court's opinion. It is possible to read it as saying, in effect, that the Commission's expertise always entitles it to say that the compensating advantages of increased competitiveness outweigh the loss of economies in a given case, and that when the Commission has so spoken, its judgment is unreviewable. Were this, however, the Court's intent, there would have been no occasion for remand for our further deliberation. The order

of remand would have directed us to affirm the Commission's order.

Furthermore, we note that the shared management on which the Commission posits its language quoted above is common to utility holding company systems, not peculiar to NEES. In effect the Commission says that an independent gas company is always likely to do better than one affiliated with electric companies. *Cf. The North American Co.*, 1945, 18 S.E.C. 611. That is precisely the sort of empirical judgment that the Commission is best qualified to make in the light of its expertise, acquired from dealing with utility company systems over the decades. And we read the Court's opinion as saying that the Commission is entitled to take that judgment into account as justifying a stringent test of "substantiality". But, that done, the general judgment has no independent significance in an individual case. Were this not so, a single statutory standard would be read to set forth two test: first, is the loss of economies so substantial as to cause serious impairment of the companies' ability to survive; and, second, even if a loss of such magnitude is probable, is its impact sufficently offset by efficiencies of independent operation so that it is no longer substantial? We cannot escape the conclusion that expert judgment on the impact of gains from increased competition must be involved in answering the first question and that a two-step approach is both artificial and unrealistic.

Absent a finding, therefore, that the company to be divested has been suppressed for the benefit of its affiliates, see *The North American Co., supra*, or that some definable particularized benefit will accrue from divestment, we think the Commission should confine itself to a quantitative analysis of the substantiality of the proved losses. Since we read the Commission's opinion as improperly attributing independent significance to the generalized competitive advantages here, and since—as we have explained above—we do not read the opinion as expertly evaluating the evidence in the light of the proper meaning of the statutory term, we are compelled to vacate the order of divestment and remand the case for further proceedings and an analysis by the Commission responsive to the difficulties which we have set forth.

# APPENDIX

The following table is derived entirely from figures appearing in the Commission's opinions in five utility divestment cases before 1948.[1] Its purpose is to indicate the significance of those figures in the Commission's reasoning in each case, and their reliability as a guide for the decision of later cases. It may be noted, for instance, that in the three cases where the claimed losses constituted relatively large percentages of net income (Virginia Elec. & Pow. Co.; Gulf gas; St. Louis Co.) the loss estimate was held to be substantially overstated, so that the Commission had no need to consider the "substantiality" of the resulting percentages. Even when the Commission adverted directly to the percentages given it did not attempt a prediction of their economic impact on the companies involved.

We must disapprove entirely of the practice adopted by the Commission after 1948 of comparing the ratios before it with similar ratios derived, not from the opinions in previous cases, but from the papers and records in its files.[2] In those circumstances there can be no assurance that the figures relied upon played *any* part in the decision of the cases.

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[1] *The North American Co.*, 1945, 18 S.E.C. 611 [NoAmer]; *The Middle West Corp.*, 1944, 15 S.E.C. 309 [MidWest]; *Cities Serv. Co.*, 1944, 15 S.E.C. 962 [CitServ]; *Cities Serv. Power & Light Co.*, 1943, 14 S.E.C. 29 [CSPowL]; *Engineers Pub. Serv. Co.*, 1942, 12 S.E.C. 41, *rev'd on other grounds*, D.C. Cir., 1943, 138 F.2d 936, *dismissed as moot*, 1947, 332 U.S. 788 [EngPS].

[2] *General Pub. Util. Corp.*, 1951, 32 S.E.C. 807. We note more in sorrow than in anger that in the present case the Commission included for comparison the 1954 operating figures of the gas properties of the Louisiana Power and Light Co., which were ordered divested in 1953, in *Middle South Util. Inc.*, 1953, 35 S.E.C. 1, *vacated sub nom. Louisiana Pub. Serv. Comm'n* v. *SEC*, 5 Cir., 1956, 235 F.2d 167, *rev'd on other grounds*, 1957, 353 U.S. 368.

| | Case | Amount of Loss Claimed | Per Cent of — *Operating Revenues* | *Op. Rev. Deductions* | *Gross Income* | *Net Income* | Remarks |
|---|---|---|---|---|---|---|---|
| EngPS | Va. E&P Co.[a] | $ 71,500[b] | 3.4 | n/a | 13.2 | 29.5 | *Held,* existing misallocation of costs between gas and electric operations seriously inflated loss figures. |
| | Savannah E&P | 28,000 | n/a | 2.2 | 3.4 | 5.5 | |
| | Gulf gas | 42,024[b] | n/a | 8.7 | 25.6 | 32.6 | *Held,* claimed loss figure included cost of unnecessary outside supervision and substantially overstated projected payroll. |
| | El Paso elec.[c] | 32,800[d] | n/a | 1.8 | 3.6 | 7.4 | |
| CSPowL | St. Joseph elec. | 78,865[b] | 2.7 | 5.2 | n/a | n/a | *Held;* claimed loss figure overstated salaries and included cost of unnecessary personnel. |
| | Sheridan Co.[c] | n/a | n/a | 7.0[d] | n/a | n/a | See note [c] below. |
| | Rawlins elec. | 7,600[b] | 5.0 | 11.0 | n/a | n/a | *Held,* claimed loss figure substantially overstated, *e.g.,* officers' salaries. |
| CitServ | Arkansas gas | 96,181[d] | 1.1 | 2.7 | n/a | n/a | |
| Midwest | Ky. Util.[c] | 135,000[d] | 1.0 | n/a | n/a | n/a | |
| | Central Ill.[c] | 80,000[d] | 0.4 | n/a | n/a | n/a | |
| | Wisc. Power[c] | 146,000[d] | 1.3 | n/a | n/a | n/a | |
| | Lake Super.[c] | 50,500[d] | 1.9 | n/a | n/a | n/a | |
| NoAmer | St. Louis Co.[a] | 182,900[d] | 5.8 | 7.4 | 27.6 | 32.1 | Percentages not calculated by Commission or relied on in opinion. Evidence indicated that gas company was being suppressed for benefit of affiliated electric companies. |

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[a] The percentage figures were not given in the opinion or relied on by the Commission to support its decision; they are calculated here from other figures given in the opinion.

[b] These figures were held not to be proved and were disregarded, for the reasons indicated under "Remarks".

[c] In these cases it was held that the companies to be divested failed to meet the requirement of geographic compactness, 15 U.S.C. § 79k(b)(1)(C).

[d] These figures were held not proved by the Commission, and displaced by Commission estimates. The Commission's figures are reflected in the percentages.

ALDRICH, *Chief Judge* (Concurring). I concur in the court's opinion with one possible reservation. The court speaks of "hints in the Commission's supplemental brief that it sees the test in terms of likely death of a system if divestment is ordered." The supplemental brief seems to me very explicit; the word "hints" is a judicial euphemism for "statements." If this now stated principle is simply an unwarranted frolic on the part of counsel it is regrettable, but no harm is done. The thought lingers, however, that counsel would not make such statements without reason for so doing, and behind the back of their client. While, like the court, I would not myslf read the Commission's opinion as laying down the rule now asserted in the supplemental brief, if in truth this was the principle that the Commission applied, then its findings are even more vulnerable than we have held them to be.

For example, the matter of the asserted reduction in the new system's rate of return, discussed in the court's opinion, which the Commission considered to be of inadequate consequence, might well be insufficient to make bankruptcy imminent, if that is the test the Commission in fact applied. On the other hand, it could well be of great consequence if the test is simply one of serious impairment in the system's financial circumstances.

I would hope that on the new review this matter will be cleared up, and if it so happens that the Commission did weigh the evidence in the light of the test it now espouses in its supplemental brief, appropriate reconsideration will be given.

## DECREE

March 31, 1967

This cause came on to be heard on petition for review of an order of the Securities and Exchange Commission, and was argued by counsel.

Upon consideration whereof, It is now here ordered, adjudged and decreed as follows: The order of divestment of the Securities and Exchange Commission is vacated and the case is remanded for further proceedings not inconsistent with the opinion filed today.

By the Court:

/s/ ROGER A. STINCHFIELD
Clerk.

Enter:

/s/ ALDRICH, Ch.J.

JUN 28 1967
JOHN F. DAVIS, CLERK

No. 305

# In the Supreme Court of the United States

OCTOBER TERM, 1967

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SECURITIES AND EXCHANGE COMMISSION, PETITIONER

*v.*

NEW ENGLAND ELECTRIC SYSTEM, ET AL.

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*PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT*

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# INDEX



## CITATIONS

# In the Supreme Court of the United States

OCTOBER TERM, 1967

No.

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

*v.*

NEW ENGLAND ELECTRIC SYSTEM, ET AL.

*PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT*

The Solicitor General, on behalf of the Securities and Exchange Commission, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the First Circuit, entered in this case on March 31, 1967.

## OPINIONS BELOW

The opinion of the court of appeals on the judgment sought to be reviewed here (App. A, *infra*, pp. 16-38) is not yet reported. The findings and opinion of the Securities and Exchange Commission (R. 1254-1282; App. B, *infra*, pp. 40-73) are reported at 41 S.E.C. 888. An earlier opinion of the court of ap-

peals (App. C, *infra*, pp. 74-97) is reported at 346 F. 2d 399. This Court's opinion reversing the court of appeals' first decision is reported at 384 U.S. 176.

## JURISDICTION

The judgment of the court of appeals (App. A, *infra*, p. 39) was entered on March 31, 1967. We invoke the jurisdiction of this Court under 28 U.S.C. 1254(1).

## QUESTIONS PRESENTED

Section 11(b)(1)(A) of the Public Utility Holding Company Act of 1935 permits a public utility holding company to control more than one integrated public utility system only if separation would entail "the loss of substantial economies." In *Securities and Exchange Commission* v. *New England Electric System*, 384 U.S. 176, this Court (reversing the court of appeals, which had set aside the Commission's order) held that the statute is not satisfied by showing that separation will result in a substantial business loss; the economies from retention must be so important that their loss would cause a serious impairment of the separated system. On remand the court of appeals again set aside the Commission's order. The basic question presented is whether, in so doing, the court misapprehended the standard laid down by this Court for interpreting the substantial-economies provision and improperly shifted the burden of proof on the issue of substantial economies from the holding company to the Commission. In addition, we present

these specific questions which are facets of the lower court's basic error:

1. Whether the Commission, in deciding whether a loss of substantial economies would occur, was entitled to consider offsetting advantages that the separated system would likely enjoy by reason of independent operation, without attempting to fix a specific dollar value therefor.

2. Whether the Commission, having found that respondent's study of the added costs of independent operation contained serious deficiencies, was entitled to reject the study in its entirety as providing an unreliable basis for determining whether divestiture of the gas properties would cause a loss of substantial economies.

3. Whether the Commission, having found on the basis of evidence concerning comparable utility systems that the separated system would have an adequate margin of revenue over costs for successful independent operation, was also required to make a specific determination as to the system's future rate of return and its effect upon the cost and availability of financing.

## STATUTE INVOLVED

Section 11(b) of the Public Utility Holding Company Act of 1935, 49 Stat. 820, 15 U.S.C. 79k(b), provides in pertinent part:

> It shall be the duty of the Commission, as soon as practicable after January 1, 1938:

(1) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such action as the Commission shall find necessary to limit the operations of the holding-company system of which such company is a part to a single integrated public-utility system, * * * *Provided, however*, That the Commission shall permit a registered holding company to continue to control one or more additional integrated public-utility systems, if, after notice and opportunity for hearing, it finds that—

(A) Each of such additional systems cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system * * *.

## STATEMENT

Respondent, New England Electric System ("NEES"), is a holding company registered under Section 5 of the Public Utility Holding Company Act of 1935, 49 Stat. 812, 15 U.S.C. 79e. It controls utility companies serving electric customers in New Hampshire, Massachusetts, Rhode Island and Connecticut and retail gas companies in Massachusetts. In 1957 the Securities and Exchange Commission, pursuant to Section 11(b)(1) of the Act, instituted proceedings to determine (among other questions) whether NEES was entitled to retain the gas companies. Section 11(b)(1) provides that a registered holding company, unless it qualifies for an exception

under the statute, may control only a single integrated public utility system. NEES' electric companies have been found to constitute such a system (*New England Electric System*, 38 S.E.C. 193), and NEES has elected to retain them in the event that it is forbidden to control the gas companies as well. NEES argued that it was entitled to retain the gas system under the exception provided by clause (A) of 11(b)(1), which permits retention of an additional system that "cannot be operated as an independent system without the loss of substantial economies * * *." After extended hearings, the Commission rejected this contention and ordered the divestiture of the gas companies. 41 S.E.C. 888; App. B, *infra*, pp. 40-73.

In its initial review, the court below set aside the Commission's order on the ground that the Commission had misinterpreted the statutory expression, "loss of substantial economies." In the court's view, it meant simply a substantial business loss. 346 F. 2d 399; App. C, *infra*, pp. 74-97. This Court reversed. 384 U.S. 176. It approved the Commission's interpretation, which requires a showing that the "additional system cannot be operated under separate ownership without the loss of economies so important as to cause a serious impairment of that system." 384 U.S. at 179. The Court remanded the case to the court of appeals for "review of the challenged order in light of the proper meaning of the statutory term." *Id.* at 179-180.

On remand, the court below again set aside the Commission's order. Proceeding on the premise that the Commission is to be held to a "most stringent" standard in evaluating a defense of loss of substantial economies (App. A, *infra*, p. 22), the court identified three areas where, in its view, the Commission's analysis had been deficient. The first related to a cost study (the "Ebasco" study) introduced by NEES in the Commission proceeding, which purported to show that the gas system would incur some $1 million annually in additional costs of billing, meter reading, accounting and other items if divorced from the electric system. On the basis of an analysis as to which the court of appeals said, "[w]e do not necessarily criticize the Commission for its skepticism in the specifics" (App. A, *infra*, p. 24), the Commission had found that the study was deficient in a number of particulars and not a reliable basis for measuring the costs of independent operation, especially in view of its inconsistency with the experience of comparable independent gas systems (see *infra*, pp. 6-7). The court of appeals held, however, that the Commission had erred in rejecting the study *in toto;* that it should have ascertained whatever reduced amount the study supported and determined whether that amount was substantial (App. A, *infra*, pp. 24-25).

Second, NEES had argued to the Commission that since gas companies in New England operate on a small margin of revenue over costs—this because of the high cost of gas in that region—its gas system could not afford such added costs as might be entailed

by independent operation. The Commission had rejected this contention, noting, among other things, that other gas systems in Massachusetts operate profitably, including those not under common control with electric systems; that the gas system resulting from separation would be the second largest in the region; and that its ratio of costs to revenue—even assuming that the estimate of losses contained in the Ebasco study was correct—would compare favorably with other Massachusetts gas systems. The court of appeals found the Commission's answer inadequate. It held that "the focus must be on the specific characteristics of the NEES companies"—in particular, on whether the rate of return that the gas system would enjoy after separation would be large enough to attract the new investment necessary for the survival and growth of the system (App. A, *infra*, pp. 27-28).

Finally, in finding that NEES' gas system could effectively stand alone, the Commission had relied in part on a presumption drawn from the history and purpose of the Public Utility Holding Company Act and from its own experience that a gas system is more likely to prosper if it is free from the control of a holding company that has interests in a competing power source. The court of appeals, however, held that the Commission could not give "independent significance to the generalized competitive advantages" that it had found but must "confine itself to a quantitative analysis of the substantiality of" the economies lost (*id.*, pp. 33-34).

The court ordered the case returned to the Commission "for further proceedings and an analysis by the Commission responsive to the difficulties which we have set forth" (*id.*, p. 34).

## REASONS FOR GRANTING THE WRIT

In its previous decision, the court of appeals held that "'the loss of substantial economies' warranting the retention by a public utility holding company of an additional system means simply a substantial business loss. In its present decision, the court of appeals, bowing to this Court's intervening ruling, *Securities and Exchange Commission* v. *New England Electric System*, 384 U.S. 176, acknowledged that a loss large enough to cause a serious impairment of the separated system must be shown, but went on to hold that the Commission's action in rejecting a defense of loss of substantial economies must withstand a "most stringent" scrutiny and that, so tested, the Commission's order was fatally deficient. So ruling, the court fell into error which should be corrected because of its substantial adverse impact upon the administration of the Public Utility Holding Company Act.[1]

1. The basic error of the court of appeals, in our view, is its notion that the Commission, rather than

[1] In our petition for a writ of certiorari in the prior *NEES* case, No. 636, O.T., 1965, pp. 12-15, we noted the large number of potential proceedings that could be affected by a ruling on the meaning of "loss of substantial economies". Those observations apply equally to the present case, and we incorporate them by reference.

the holding company, bears a "most stringent" burden of proof on the question whether separation will involve a loss of substantial economies within the meaning of the Act. This inverts the scheme of the Act and is directly contrary to the principles of this Court's *NEES* decision last Term. The proviso in Section 11(b)(1) represents an exception to the basic policy of limiting a registered holding company to the operation of a single integrated public utility system. This Court so stated when it explained that "[t]he requirement in § 11 of a 'single integrated' system is the 'very heart' of the Act. The retention of an 'additional' integrated system is decidedly the exception." 384 U.S. at 180, quoting *North American Co. v. Securities and Exchange Commission*, 327 U.S. 686, 696-697, 704, n. 14. Since Congress' basic policy was to create independent utility systems, the Court deemed appropriate "a much more stringent" and exacting standard defining when a loss of economies is substantial than the court of appeals' business-loss test. 384 U.S. at 181-183.

It follows, we think, that the burden of establishing entitlement to retention of an additional system on the ground of loss of substantial economies is on the holding company and is a heavy one, and that deficiencies in the proof on the issue should be resolved against the company, not against the Commission's order of divorcement. Cf. *United States v. First City National Bank of Houston*, 386 U.S. 361. The court here, however, believing that the Commission's case on substantial economies, rather than

the holding company's, must withstand stringent scrutiny, resolved all doubts in favor of retention.

For example, while not rejecting the Commission's finding that the cost study introduced by NEES to show the amount of the loss that separated operation would entail contained serious deficiencies which undermined its reliability, the court held that the Commission was responsible for supplying an accurate estimate of the loss. If, as we believe, the basic policy of the Act is against the retention of additional systems and the burden of establishing an exception is upon the holding company, the Commission should not be required to remedy the deficiencies in the holding company's proof. Having failed to submit a study that provided a satisfactory basis upon which to predicate a finding that the economies to be lost upon divestiture would be substantial, NEES did not sustain its burden of showing that the additional system was retainable, and the Commission's order should have been sustained.

Similarly, we think the court erred in holding, in the circumstances of this case, that the Commission's order could not stand in the absence of a specific finding that the rate of return of the gas system under independent operation would be adequate to generate additional capital necessary for the system's survival and growth. What the court did was to calculate the rate of return that the gas system would enjoy on the hypothesis that the estimate of losses contained in the Ebasco study was correct, from which it concluded that the resulting rate—4.1 percent—was so low that additional inquiry by the Commission was

required (App. A, *infra*, pp. 29). The court, however, ignored the fact that the Commission, on the basis of an analysis largely unchallenged by the court, had found the study to be an unreliable guide. The flaws in the study found by the Commission and the inherently speculative character of an estimated rate of return based upon such projections made the level of return of little significance here in evaluating the substantiality of the claimed increases in expenses upon divestiture. This was particularly so in view of the substantial evidence before the Commission indicating that, notwithstanding the alleged losses that separation might entail, the gas system was perfectly capable of thriving under independent operation.

Thus, the Commission noted that the separated gas companies would constitute the second largest gas system in Massachusetts; that the other gas systems in the area were thriving, although some have no affiliation with an electric system; that the ratio of costs to revenue of the NEES gas system after separation would compare favorably with the other Massachusetts systems even accepting the inflated loss figure submitted by NEES;[2] that any losses immediately consequent on divestiture might well be compensated for by the benefits that could be expected to flow from freeing the gas system from domination by a holding company controlling a competing form of energy;

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[2] NEES selected these companies as a basis for comparison to support its own projected estimates of the post-separation costs of NEES's gas system. Yet, in the court below, it disputed the propriety of the Commission's drawing its own inferences from the costs of these companies.

and, finally, that the projected losses were not out of line with those found to be insubstantial in previous divorcement proceedings under the Act. Such comparative evidence would appear far more objective and probative than a necessarily speculative attempt to predict from estimated loss of economies the gas system's ability to attract necessary new capital, or to forecast the losses that the system might incur if it failed to explore other ways besides common ownership with an electric system of achieving operating economies. In any event, NEES presented no evidence to show that the NEES gas system is so different from other Massachusetts gas systems that a detailed analysis of its specific characteristics is necessary.

It is apparent from the foregoing that the court of appeals' decision, if followed, would greatly complicate the trial of holding company cases. This case, already in its tenth year, would be extended substantially. The Commission's resources for administering the holding company program would be sorely strained. And if all doubts are to be resolved in favor of retention—the basic theme of the court of appeals' decision—the statutory plan generally to limit holding companies to a single system will be robbed of its practical efficacy and this Court's *NEES* decision set at naught. Consequences so serious plainly require review by this Court.

2. Besides unwarrantedly extending the scope of the inquiry that the Commission must make in a holding company case, the court below improperly curtailed the Commission's discretion with respect to

an important issue in such cases: whether, in weighing the impact of the added costs of independent operation, the Commission may recognize as an offsetting consideration the advantages to the independent operator that are likely to flow as a result of his freedom from domination by a holding company that has a financial stake in a competing energy source. As this Court noted in *Securities and Exchange Commission* v. *New England Electric System*, 384 U.S. 176, 183, "One of the evils that had resulted from control of utilities by holding companies was the retention in one system of both gas and electric properties and the favoring of one of these competing forms of energy over the other." The Court expressly noted in its *NEES* opinion that the Commission in this case had "found that any losses of economies would be offset by the benefits that would flow from the healthy competition between the independently controlled gas and electric companies" (384 U.S. at 179), and commented (*id.* at 184-185):

> Competitive advantages to be gained by a separation are difficult to forecast. The gains to competition might well be in the public interest and might well offset the estimated loss in economies of operation resulting from a separation of the gas properties from the utility system. This is a matter for Commission *expertise* on the total competitive situation, not merely on a prediction whether, for example, a gas company in a holding company system may make more for investors than a gas company converted into an independent regime.

The court below quoted this language, but in disregard of its clear import held that the advantage of competition is something the Commission is "entitled to take into account * * * as justifying a stringent test of 'substantiality.' But, that done, the general judgment has no independent significance in an individual case" (App. A, *infra*, p. 33). The language of this Court, quoted above, makes clear that offsetting benefits are relevant not merely to the formulation of the statutory standard for determining when the loss of economies is substantial—as the court of appeals suggested in its second opinion—but to the application of the standard in a particular case as well. Nor is it tenable that the Commission can take such benefits into account only in a case where they can be translated into a precise dollar figure. Such a requirement is impossible to comply with; to impose it is to deny any role to offsetting benefits. The requirement is also unsound. That the benefits of free and independent competition cannot be quantified does not make them insubstantial or unworthy of consideration. A qualitative judgment is indeed required, but that is precisely the kind of judgment which this Court on its earlier review of this case stated the Commission was empowered to make. In reading this factor out of holding company cases, the court below has refused to give effect to the policy of the Act and to the principles announced by this Court when the case was last here.

## CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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RICHARD A. POSNER,
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*Securities and Exchange Commission.*

JUNE 1967.

## APPENDIX A

# UNITED STATES COURT OF APPEALS
For the First Circuit

No. 6332

NEW ENGLAND ELECTRIC SYSTEM, ET AL.,
PETITIONERS

*v.*

SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

On Petition for Review of an Order of the
Securities and Exchange Commission

Before ALDRICH, *Chief Judge*,
WOODBURY*, *Senior Judge*, and COFFIN, *Circuit Judge*

*John R. Quarles*, with whom *Richard B. Dunn*, *Richard W. Southgate*, *John J. Glessner, III*, and *Ropes & Gray* were on brief, for petitioners.

*David Ferber*, Solicitor, with whom *Philip A. Loomis, Jr.*, General Counsel, *Martin D. Newman*, Attorney, *Solomon Freedman*, Director, Division of Corporate Regulation, and *Aaron Levy*, Assistant Director, Division of Corporate Regulation, were on brief, for respondent.

March 31, 1967

COFFIN, *Circuit Judge*. This petition for review of a Securities and Exchange Commission order is before us for a second time, on remand from the Su-

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* By designation.

preme Court. The petitioner, New England Electric System (NEES), is a registered holding company controlling fourteen electric utility and eight gas utility companies in the New England states. In August 1957 the Commission instituted proceedings to determine whether NEES was entitled to retain that control under the standards of section 11(b)(1) of the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79k(b)(1). Extensive hearings, resulting in a record of nearly 1,500 pages, culminated in the Commission's order of March 19, 1964, requiring NEES to divest itself of all its gas companies.

In our earlier opinion, as here, we focused primarily on the Commission's application to the NEES system of the "substantial economies" test of section 11(b)(1)(A), 15 U.S.C. § 79k(b)(1)(A). Generally, section 11(b)(1) allows a holding company to control only one system of operating utility companies. However, control of an additional integrated public utility system [1] is permitted if, in addition to size and location requirements not here in dispute, the Commission finds that the system "cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control" by the holding company.

We held that the statutory words, "loss of substantial economies", called for "a business judgment of what would be a significant loss, not for a finding of

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[1] As applied to gas companies, an integrated public utility system is "a system consisting of one or more gas utility companies which are so located and related that substantial economies may be effectuated by being operated as a single coordinated system confined in its operations to a single area or region . . . ." 15 U.S.C. § 79b(a)(29)(B). The Commission held, and it is assumed here, that the eight gas companies constitute such a system.

total loss of economy or efficiency". *New England Elec. System* v. *SEC*, 1 Cir., 1965, 346 F.2d 399, 406. Since we read the Commission's opinion as holding incorrectly that lost economies would not be substantial unless divestment would render "economical or efficient operation" impossible, and since we believed that under the appropriate standard the Commission could have found for NEES on the record before it, we ordered the case remanded. The Supreme Court reversed, holding that the Commission's interpretation of the statute was correct, and remanded the case to us for review of the Commission's order in light of the proper meaning of the statutory term. *SEC* v. *New England Elec. System*, 1966, 384 U.S. 176.

In approving the Commission's interpretation of section 11(b)(1)(A), the Court said that it required a showing that the "additional system cannot be operated under separate ownership without the loss of economies so important as to cause a serious impairment of that system." 384 U.S. at 179. In illustration the Court quoted the language of the House report, that there must be a showing of "a real economic need"; of Senator Wheeler, speaking after the bill was passed, that the exception would apply only to systems "so small that they were incapable of independent operation"; and of the Commission itself, in *Philadelphia Co.*, 1948, 28 S.E.C. 35, 46, that there must be a "situation in which the proven inability of the system to stand by itself would result in substantial hardship to investors and consumers were its relationship with the holding company terminated." Finally, the Court concluded (1) that the proper test was "much more stringent" than a business judgment of significant loss; (2) that while economy in man-

agement was one theme of the act, eliminating restraint of free competition was another; and (3) that offsetting gains to competition, difficult to forecast, were "a matter for Commission *expertise* on the total competitive situation, not merely on a prediction whether, for example, a gas company in a holding company system may make more for investors than a gas company converted into an independent regime." 384 U.S. at 185.

The only area remaining for definitional dispute is whether the holding company, to justify retention, must prove that severance will result in imminent bankruptcy of the subsidiary, or something less—a condition allowing survival but not on a sound or "healthful continuing" basis, *Engineers Pub. Serv. Co.* v. *SEC*, D.C. Cir., 1943, 138 F.2d 936, 944. We think the answer lies in the latter definition. This, we think, stems from a careful reading of the Court's opinion, particularly in the light of the Commission's opinion which it was interpreting.

We have taken pains to summarize the sequence of quotations cited by the Court, all of which have been relied on by the Commission, because, while they are internally consistent in militating against a test of business judgment of probable significant loss, they suggest that the Commission has not always been clear as to whether it considers "serious impairment" or "inability to survive" the standard. The first two quotations are consistent with the former; the last two, with the latter.

That the Court's use of the "serious impairment" language reflected the fair import of the Commission's opinion is clear. That opinion contained only one reference—to Senator Wheeler's language above quoted—consistent with an "inability to survive" test. Its

remaining verbalizations were "real economic need" (House Report language above quoted); "ability of the additional system to operate soundly" (Commission's own formulation); "important economies" (*North American Co.* v. *SEC*, 2 Cir., 1943, 133 F.2d 148, 152) related to "the healthful continuing business and service of the freed utility" (*Engineers Pub. Ser. Co.* v. *SEC*, *supra*); and the conclusion of the Commission in its own words that "a registrant seeking to retain an additional system has the burden of showing . . . that such additional system cannot be operated under separate ownership without the loss of economies so important as to cause a serious impairment of that system." The Court, therefore, advisedly chose this language as "the Commission's reading of Clause (A)".

We also observe that if Congress had meant to allow retention only when the alternative was extinction, the test of section 11(b)(1)(A) could have been shortened to require a finding that the subsidiary "cannot be operated as an independent system." Furthermore, the Court's emphasis on the likelihood of offsetting gains to competition presupposes the continued operation of the gas companies—we cannot imagine that competition would gain from the elimination of competitors. Finally, it is as impossible to say that "serious impairment" of an additional utilities system means "inability to survive" as to say that "serious injury" means "death."

We take the trouble to distinguish between these two remaining possible approaches because of hints in the Commission's supplemental brief, signed by its General Counsel and argued by its Solicitor, that it sees the test in terms of likely death of a system if divestment is ordered. This brief articulated the "Question Involved" as follows:

"[T]he only question remaining for this Court's consideration is whether the Commission correctly held that petitioners failed to sustain their *burden of proof that NEE'S integrated gas utility system was unable to stand by itself so that substantial hardship to that system's investors and consumers would result from a termination of its relationship with NEES.*"

(Emphasis added.)

This manner of stating the question ignores the "serious impairment" language to which the Court gave first attention in its opinion, but draws exclusively from the language quoted from *Philadelphia Co., supra.* The Commission's wording of the "Question" also makes it clear that a system's inability "to stand by itself" is the event bringing about the "substantial hardship" to investors and consumers. This reading of the test is made more clear by the brief's truncated quotation of *Philadelphia Co.* in saying that that case places "upon petitioners the burden of proving the 'inability of the additional system to stand by itelf.' ". The significance of hardship to investors and consumers is ignored. As final corroboration, it is to be noted that this abbreviated quotation from *Philadelphia Co.* is immediately followed by the statement, "in the light of this test . . . there is no basis for petitioners' arguments that [the statute means] 'such loss [as] would impair the gas companies' ability to compete effectively . . . .' "

It seems too probable to us, therefore, that the Commission, at least in its supplemental brief, now views the statute as requiring divestment unless petitioners can prove that they could not operate as an independent system. Such a test would, we think, read out of the statute the phrase "without the loss of sub-

stantial economies" and would distort the Court's imprimatur on the words "serious impairment".

Even without the burden of proving likely demise, petitioner's burden is, as the Court said, to meet "a much more stringent test" than that of a probable significant loss. But, if the standard to be applied to petitioner is stringent, so is the level of analysis and expertise to be exercised by the Commission. We have, only after a fresh review of all the evidence in the light of this *most stringent* practical standard, concluded that the Commission's opinion does not reveal that application of both reason and experience to facts which merits endorsement as the responsible exercise of expertise.

To make intelligible our difficulties it is necessary to review again the basic facts in evidence and the Commission's express bases for decision. The eight gas companies involved are operated under the general control of the NEES Gas Division, whose officers are responsible directly to the general officers of the holding company and have no duties regarding the electric companies. Seven of the eight operate in areas overlapping the service areas of one or more NEES electric companies and share some facilities, such as office space, meter readers, and accounting personnel and equipment. Both the gas and the electric companies obtain services such as supervision of accounting, purchasing, insurance, legal counsel, labor relations administration, and handling of rate matters from the New England Power Service Corporation, another subsidiary of NEES. In most other respects the gas companies are operated as an independent system, in competition with NEES and other electric companies and with numerous unregulated oil companies.

To support retention, NEES offered the report of a study by a professional utility engineering and consulting firm, Ebasco Services, Inc. (Ebasco), projecting the results of severance on the gas companies, in terms of increased cost of operations. The report presented a detailed description of the organization and operation of the gas companies as of 1958-1959 and as projected after severance, with an estimate of the actual and pro forma costs assigned to each phase of the operations. It concluded that severance would result in recurring additional costs of $1,495,000 per year, on the assumption that the gas subsidiaries would be operated at eight wholly independent companies. A supplemental report reduced the figure to $1,098,600, on the assumption adopted by the Commission that the companies would be operated as a single integrated system.[2] The increase represented primarily the increased cost of the personnel required to duplicate the essential functions now being performed by the service company, and the loss of economies of scale now obtained by joint operation with the electric companies. The latter category included the increase in the cost of customer accounting, the loss of quantity discounts in purchasing, and the substantially increased cost of obtaining insurance against disaster losses.

The Commission rejected the Ebasco report's conclusion, on the grounds (a) that the supplemental report and the witnesses did not satisfactorily explain why the cost of customer billing could not be reduced by using a centralized system for all eight companies, rather than individual billing by each company; (b)

[2] The latter figure also reflects a reduction of $67,000 to account for a Commission-approved increase in Service Company charges to the gas companies that took effect after 1959.

that the report projected greater increases in the per-customer costs of customer accounting to some gas companies than to the NEES electric companies sharing the same facilities, without satisfactory explanation; (c) that, since the increased cost attributed to customer accounting ($472,100) constituted a large part of the total increase claimed, NEES's failure to justify the whole of that item "substantially impaired" the credibility of the entire estimate; and (d) that the estimated additional salaries and/or positions for the top executive staff of the gas system were also suspect.

Nothing in the Court's opinion causes us to change our views on this issue as expressed in 346 F.2d at 407-09.[3] We do not necessarily criticize the Commission for its skepticism in the specifics; but we do think that even taken together these items constitute at most a basis for reducing the estimated figure by some amount, not for concluding that no increased costs have been proved. In fact, the record here demonstrates conclusively that *some* increased costs are inevitable—the only doubt possible concerns the amount. Furthermore, we think that if the Commission is to use its expertise to assess the impact of the costs in "the total competitive situation", it must at-

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[3] The Commission made another error, which we pointed out in our previous opinion, 346 F.2d at 401 n.4, namely, the imposition of too heavy a standard of proof. The Commission persists in saying that "by clear and convincing evidence" means the same thing as "by a fair preponderance of the evidence." With the exception of one court of appeals decision, which we stated before we would not follow, all courts that we know of consistently recognize what to us seems self-apparent, that there is a significant difference. McCormick, Evidence (1954) ch. 36, § 320. For a recent observation on this subject, see *Woodby* v. *INS*, 1966, 385 U.S. 276.

tempt to determine some acceptable figure as a predicate for its assessment. Since, however, the Commission here proceeded on the alternative ground that the full amount of the Ebasco loss estimate ($1,098,600) was proven, we pass further discussion of the amount of losses and turn to their impact.

On this issue, NEES presented evidence that, because of their position at the end of the pipelines, the high cost of manufacturing gas locally, and the absence of storage facilities, the gas companies of New England pay the highest price in the country for the gas they sell, and consequently enjoy little or no price advantage over oil in the important house heating market. Electricity is competitive, apparently, only in a quality market, but has shown better progress than expected. The growth of gas sales in New England, while showing a high percentage increase from a very low base, has lagged substantiallly behind the rest of the country in saturation of the market. Evidence was offered that, although the NEES gas companies have shown a higher rate of growth, of revenues, of increase in saturation, of earnings, and of return on sales expenses, and lower operating expenses than other gas companies in Massachusetts, they have also shown a lower sales revenue per customer. NEES officers and representatives of the Massachusetts Department of Public Utilities testified that the NEES companies operate in areas of slow population growth, as compared to other companies in the state.

To this the Commission responded (a) that as to the geographical disadvantage of operating in New England, the NEES gas companies were in no worse position that the non-affiliated Massachusetts companies which have "apparently" been able to earn a fair return; (b) that the NEES companies, being the sec-

ond largest gas utility operation in Massachusetts, should be able to provide itself with management comparable to the others'; (c) that the NEES gas companies' operating ratio[4] of 76.41 per cent would compare favorably to others in the area; (d) that there was no "specific demonstration" of a causal relation between population growth and gas sales; (e) that the projected losses, even if assumed to be proved, were not substantial within the meaning of section 11 (b) (1) (A), because the ratios of the losses to revenues (4.83 per cent), to operating expenses (6.03 per cent), to gross income (23.28 per cent), and to net income (29.94 per cent)—"the test of substantiality of the estimated loss"—were lower or not substantially higher than similar ratios in prior cases where divestment had been ordered; and (f) that in any event, despite the relatively independent operation of the gas subsidiaries, the operation did not secure the competitive advantages obtainable from single-minded independent management.

We have taken the trouble of including all of the Commission's expressed bases for decision because of our conviction that they do not communicate to us the application of agency expertise in this critical area. For it is here that the delicate judgments—informed by experience, sharpened by close analysis, and ripened into the soundest possible intuition about what is likely to happen—that we call expertise, come into play. Cost accountants, efficiency experts, and engineers can arrive at figures for the likely increases of costs. But a wider-ranging inquiry must be made

[4] "Operating ratio" is defined as the percentage of total operating deductions (excluding depreciation, amortization of conversion costs, and federal income taxes) to total operating revenues.

to arrive at an educated guess whether the increased burden, falling on a company in the economic and competitive situation of the gas companies involved here, will amount to substantial lost economies—whether its effect will be undue harm to the companies' investors and customers. The importance of care and discrimination in the conduct of this inquiry is underscored by the Supreme Court's clarification of the statutory standard. That the line of "serious impairment" is drawn so close to the point of probable business failure makes the holding company's burden of proof more difficult to carry; but it also makes the risk more substantial that a divestment order based on erroneous findings will result in economic disaster.

With this in mind, we must conclude that the Commission's analysis in the present case does not adequately address the coniderations relevant to the ultimate issue it is required to resolve. To be sure, the evidence summarized above is far from conclusive; and it cannot be denied that there are imponderable factors. At the time of the hearing, the gas companies in New England were considering several ways of reducing their basic costs, such as development of local storage areas, construction of a plant to manufacture liquefied natural gas, and importation of gas by ocean tanker. At the same time they feared that existing oil import restrictions might be loosened. It may be that in the intervening years some of these possibilities have ripened to change the basic competitive circumstances. Nevertheless, we can only conclude on the present record that all gas in New England operates on, as one witness testified, a small cushion. The significance of this is not negated by observing that non-NEES companies in Massachusetts seem to be surviving, for the focus must be on

the specific characteristics of the NEES companies, the only ones affected by the Commission's order. Similarly, that the NEES gas companies together would be the second largest system in Massachusetts is a descriptive, not an analytical proposition. It offers little help in assessing ability to survive. Indeed, the record here is silent on the economic health of the largest system.

A more precise basis for the Commission's decision lies in its use of ratios of the estimated losses to revenues, expenses, and income, in comparison with those adduced from previous divestment cases. The use of these ratios as a test is posited on the undeniable observation that, "in the context of clause (A), the 'substantiality' of asserted losses of economies cannot be tested in absolute terms but rather must be evaluated in relation to total revenues, expenses and income." *Philadelphia Co.*, 1948, 28 S.E.C. 35, 48-49, *aff'd*, D.C. Cir., 1949, 177 F.2d 720. But we observe further that, where the statutory test of substantiality is understood in terms of potential harm to the investor and consumer, even these ratios are significant only as they affect the investment structure of the companies in the particular case, and different companies may be compared only on the assumption that both operate at the same level.

For example, suppose two utility companies, one earning a rate of 6 per cent return on its investment and the other a rate of 5 per cent,[5] both suffer losses amounting to 15 per cent of net income. The result

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[5] Rate of return is defined as the percentage of net operating income to the rate base, which is fixed by a rather complicated formula tied generally to the value of capital assets. It may be noted that where only the percentage change is being considered, the amount of the rate base is irrelevant.

would be to reduce the rates of return to 5.1 per cent and 4.25 per cent respectively. It is entirely possible that the former company would be able to maintain its investment position and operate without a rate increase, while the latter would be unable to produce what would be considered a fair return. In fact, in the present case the projected loss to the NEES gas companies amounted to 30 per cent of net income. At the hearing the Commission staff adduced evidence showing that this loss would decrease the companies' rate of return from 6.4 per cent in 1959 to *4.1 per cent* on the projected basis. This may be compared with an average rate of 5.9 per cent for the non-affiliated Massachusetts gas companies, and is below the minimum of 4.5 per cent. Yet, despite the staff's initiative in securing this obviously important data, the Commission failed even to discuss it, except to observe that "apparently" the non-affiliated companies were earning a fair return. We cannot assume, without reason, that a projected rate of return for the NEES companies which is 30 per cent below the average for their counterparts is irrelevant to the issue of "serious economic impairment".

Nor is it sufficient that the loss ratios considered here are "not significantly higher" than the corresponding ratios of companies ordered divested in previous cases. It is obvious from our discussion above that, even if the companies compared were operating at the same level before divestment, the point must come where a small increase in the percentage loss of income crosses the line between a fair return on investment and one so low as to trigger disinvestment or require rate increases. Moreover, where that line is drawn must depend, among other things, on the market position of the company involved. Com-

parison with figures derived from the situations of other companies in other places at other times cannot be conclusive.[6]

In short, we think the standard of "substantial economies", developed by the Commission itself and affirmed by the Supreme Court in this case, requires the Commission—having established its best estimate of the extent of the definable losses likely to result from severance—to address itself to a prediction of the effect of those losses on the economic health of the particular companies involved, in their particular circumstances. Without pretending to define the one true test, we think it clear that relevant factors might include whether the effect of the loss will be (a) to make new equity financing only difficult, or impossible; (b) to reduce the rate of return on investment only slightly, or enough to provoke either disinvestment or a rate increase; (c) to raise the cost of borrowing money a little, or a lot; (d) if rate increases seem probable, to injure deeply, hurt slightly, or af-

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[6] The same reasoning makes irrelevant the comparison of operating ratios, since a business may operate relatively efficiently, yet at a level too low to attract investors.

The comparison-of-ratios test first acquired the status of "the test of substantiality of the claimed losses" in *Philadelphia Co.*, 1948, 28 S.E.C. 35, *aff'd*, D.C. Cir., 1949, 177 F.2d 720, where it was explained as "nothing more than the normal decisional technique of referring to and comparing the facts in prior decisions as a guide in adjudicating the pending case". 28 S.E.C. at 50 n.24. The validity of this technique presupposes that the facts selected for comparison were significant factors in the prior decisions. But it appears to us that the figures selected for use in *Philadelphia Co.* were either ignored or considered mere makeweights in the earlier cases, except in a few where the percentages were so small as to demonstrate that the claimed losses were *de minimis*. The basis for our conclusion is outlined in the Appendix to this opinion.

fect not at all the companies' ability to survive. The Commission considered none of these.

We recognize, of course, that the selection of relevant factors is for the Commission's determination in the first instance, in the exercise of its expertise. But this principle does not isolate the Commission's conclusions from review to determine whether that expetise has been exercised, and, if exercised, communicated. We do not think that the Commission's obligation, which is at the root of the respect to which its expertise is entitled, is satisfied by the invocation of largely irrelevant ratios or of other data concerning other companies, at other times, in other areas, facing possibly different conditions. Were such ratios sufficient, the resolution of divestment cases could be as well entrusted to electric desk calculators as to an expert administrative agency.

Finally, the Commission attributed some significance in this case to its doubt that "such a separation of the gas from the electric operations has been effected as to secure the kind of single-minded management for each that would obtain upon actual divestment." This conclusion was supported by the observation that other Massachusetts companies had been "more effective" in their operations, and by language best considered in the context of its quotation by the Supreme Court:

> "In the present case the Commission said on this phase of the controversy:
>
> > 'Although the NEES Gas Division handles sales and promotional activities and various other matters for the gas subsidiaries separately from the electric companies, final authority on all important matters rests in the top NEES management. The basic competi-

tive position that exists between gas and electric utility service within the some locality is affected by such vital management decisions as the amount of funds to be raised or allocated to the expansion or promotion of each type of service.'

"Competitive advantages to be gained by a separation are difficult to forecast. The gains to competition might well be in the public interest and might well offset the estimated loss in economies of operation resulting from a separation of the gas properties from the utility system. This is a matter for Commission *expertise* on the total competitive situation, not merely on a prediction whether, for example, a gas company in a holding company system may make more for investors than a gas company converted into an independent regime.

"The phrase 'without the loss of substantial economies' is admittedly not crystal clear. But the Commission's construction seems to us to be well within the permissible range given to those who are charged with the task of giving an intricate statutory scheme practical sense and application." 348 U.S. at 184-85.

We have quoted at such length because we think it important to understand precisely the meaning of this part of the Court's opinion. It is possible to read it as saying, in effect, that the Commission's expertise always entitles it to say that the compensating advantages of increased competitiveness outweigh the loss of economies in a given case, and that when the Commission has so spoken, its judgment is unreviewable. Were this, however, the Court's intent, there would have been no occasion for remand for our further de-

liberation. The order of remand would have directed us to affirm the Commission's order.

Furthermore, we note that the shared management on which the Commission posits its language quoted above is common to utility holding company systems, not peculiar to NEES. In effect the Commission says that an independent gas company is always likely to do better than one affiliated with electric companies . *Cf. The North American Co.*, 1945, 18 S.E.C. 611. That is precisely the sort of empirical judgment that the Commission is best qualified to make in the light of its expertise, acquired from dealing with utility company systems over the decades. And we read the Court's opinion as saying that the Commission is entitled to take that judgment into account as justifying a stringent test of "substantiality". But, that done, the general judgment has no independent significance in an individual case. Were this not so, a single statutory standard would be read to set forth two tests: first, is the loss of economies so substantial as to cause serious impairment of the companies' ability to survive; and, second, even if a loss of such magnitude is probable, is its impact sufficiently offset by efficiencies of independent operation so that it is no longer substantial? We cannot escape the conclusion that expert judgment on the impact of gains from increased competition must be involved in answering the first question and that a two-step approach is both artificial and unrealistic.

Absent a finding, therefore, that the company to be divested has been suppressed for the benefit of its affiliates, see *The North American Co., supra,* or that some definable particularized benefit will accrue from divestment, we think the Commission should confine itself to a quantitative analysis of the substantiality

of the proved losses. Since we read the Commission's opinion as improperly attributing independent significance to the generalized competitive advantages here, and since—as we have explained above—we do not read the opinion as expertly evaluating the evidence in the light of the proper meaning of the statutory term, we are compelled to vacate the order of divestment and remand the case for further proceedings and an analysis by the Commission responsive to the difficulties which we have set forth.

## APPENDIX

The following table is derived entirely from figures appearing in the Commission's opinions in five utility divestment cases before 1948.[1] Its purpose is to indicate the significance of those figures in the Commission's reasoning in each case, and their reliability as a guide for the decision of later cases. It may be noted, for instance, that in the three cases where the claimed losses constituted relatively large percentages of net income (Virginia Elec. & Pow. Co.; Gulf gas; St. Louis Co.) the loss estimate was held to be substantially overstated, so that the Commission had no need to consider the "substantiality" of the resulting percentages. Even when the Commission adverted directly to the percentages given it did not attempt a prediction of their economic impact on the companies involved.

We must disapprove entirely of the practice adopted by the Commission after 1948 of comparing the ratios before it with similar ratios derived, not from the opinions in previous cases, but from the papers and records in its files.[2] In those circumstances there can be no assurance that the figures relied upon played *any* part in the decision of the cases.

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[1] *The North American Co.*, 1945, 18 S.E.C. 611 [NoAmer]; *The Middle West Corp.*, 1944, 15 S.E.C. 309 [MidWest]; *Cities Serv. Co.*, 1944, 15 S.E.C. 962 [CitServ]; *Cities Serv. Power & Light Co.*, 1943, 14 S.E.C. 28 [CSPowL]; *Engineers Pub. Serv. Co.*, 1942, 12 S.E.C. 41, *rev'd on other grounds*, D.C. Cir., 1943, 138 F.2d 936, *dismissed as moot*, 1947, 332 U.S. 788 [EngPS].

[2] *General Pub. Util. Corp.*, 1951, 32 S.E.C. 807. We note more in sorrow than in anger that in the present case the Commission included for comparison the 1954 operating figures of the gas properties of the Louisiana Power and Light Co., which were ordered divested in 1953, in *Middle South Util. Inc.*, 1953, 35 S.E.C. 1, *vacated sub nom. Louisiana Pub. Serv. Comm'n* v. *SEC*, 5 Cir., 1956, 235 F.2d 167, *rev'd on other grounds*, 1957, 353 U.S. 368.

| Case | | Amount of Loss Claimed | Per Cent of: *Operating Revenues* | *Op. Rev. Deductions* | *Gross Income* | *Net Income* | Remarks |
|---|---|---|---|---|---|---|---|
| EngPS | Va. E&P Co.[a] | $ 71,500[b] | 3.4 | n/a | 13.2 | 29.5 | *Held,* existing misallocation of costs between gas and electric operations seriously inflated loss figures. |
| | Savannah E&P | 28,000 | n/a | 2.2 | 3.4 | 5.5 | |
| | Gulf gas | 42,024[b] | n/a | 8.7 | 25.6 | 32.6 | *Held,* claimed loss figure included cost of unnecessary outside supervision and substantially overstated projected payroll. |
| | El Paso elec.[c] | 32,800[d] | n/a | 1.8 | 3.6 | 7.4 | |
| CSPowL | St. Joseph elec. | 78,865[b] | 2.7 | 5.2 | n/a | n/a | *Held,* claimed loss figure overstated salaries and included cost of unnecessary personnel. |
| | Sheridan Co.[c] | n/a | n/a | 7.0[d] | n/a | n/a | See note [c] below. |
| | Rawlins elec. | 7,600[b] | 5.0 | 11.0 | n/a | n/a | *Held,* claimed loss figure substantially overstated, *e.g.,* officers' salaries. |
| CitServ | Arkansas gas | 96,181[d] | 1.1 | 2.7 | n/a | n/a | |
| Midwest | Ky. Util.[c] | 135,000[d] | 1.0 | n/a | n/a | n/a | |
| | Central Ill.[c] | 80,000[d] | 0.4 | n/a | n/a | n/a | |
| | Wisc. Power[c] | 146,000[d] | 1.3 | n/a | n/a | n/a | |
| | Lake Super.[c] | 50,500[d] | 1.9 | n/a | n/a | n/a | |

| Case | | Amount of Loss Claimed | Per Cent of— *Operating Revenues* | *Op. Rev. Deductions* | *Gross Income* | *Net Income* | Remarks |
|---|---|---|---|---|---|---|---|
| NoAmer | St. Louis Co.[a] | \$182,900[d] | 5.8 | 7.4 | 27.6 | 32.1 | Percentages not calculated by Commission or relied on in opinion. Evidence indicated that gas company was being suppressed for benefit of affiliated electric companies. |

[a] The percentage figures were not given in the opinion or relied on by the Commission to support its decision; they are calculated here from other figures given in the opinion.

[b] These figures were held not to be proved and were disregarded, for the reasons indicated under "Remarks".

[c] In these cases it was held that the companies to be divested failed to meet the requirement of geographic compactness, 15 U.S.C. § 79k(b)(1)(C).

[d] These figures were held not proved by the Commission, and displaced by Commission estimates. The Commission's figures are reflected in the percentages.

Aldrich, *Chief Judge* (Concurring). I concur in the court's opinion with one possible reservation. The court speaks of "hints in the Commission's supplemental brief that it sees the test in terms of likely death of a system if divestment is ordered." The supplemental brief seems to me very explicit; the word "hints" is a judicial euphemism for "statements." If this now stated principle is simply an unwarranted frolic on the part of counsel it is regrettable, but no harm is done. The thought lingers, however, that counsel would not make such statements without reason for so doing, and behind the back of their client. While, like the court, I would not myself read the Commission's opinion as laying down the rule now asserted in the supplemental brief, if in truth this was the principle that the Commission applied, then its findings are even more vulnerable than we have held them to be.

For example, the matter of the asserted reduction in the new system's rate of return, discussed in the court's opinion, which the Commission considered to be of inadequate consequence, might well be insufficient to make bankruptcy imminent, if that is the test the Commission in fact applied. On the other hand, it could well be of great consequence if the test is simply one of serious impairment in the system's financial circumstances.

I would hope that on the new review this matter will be cleared up, and if it so happens that the Commission did weigh the evidence in the light of the test it now espouses in its supplemental brief, appropriate reconsideration will be given.

## Decree

March 31, 1967

This cause came on to be heard on petition for review of an order of the Securities and Exchange Commission, and was argued by counsel.

Upon consideration whereof, It is now here ordered, adjudged and decreed as follows: The order of divestment of the Securities and Exchange Commission is vacated and the case is remanded for further proceedings not inconsistent with the opinion filed today.

By the Court:

/s/ Roger A. Stinchfield
Clerk.

Enter:

/s/ Aldrich, Ch.J.

## APPENDIX B

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C.
March 19, 1964

FINDINGS AND OPINION OF THE COMMISSION

In the Matter of

NEW ENGLAND ELECTRIC SYSTEM

and

ITS SUBSIDIARY COMPANIES
RESPONDENTS

File No. 59-102

Public Utility Holding Company Act of 1935—
Section 11(b)(1)

INTEGRATION OF HOLDING COMPANY SYSTEM

*Non-Retainability of Additional System*

Where registered holding company's subsidiaries conducting electric operations constitute single integrated utility system which holding company elects to retain as its principal utility system, and holding company seeks to retain other subsidiaries conducting gas operations and constituting integrated gas utility system, *held*, gas subsidiaries are not retainable as additional system where evidence is not sufficient to justify finding that "loss of substantial economies" within the meaning of Clause A of Section 11(b)(1) of the Public Utility Holding Company Act would be incurred by gas system if its retention were not permitted.

*Retainability of Other Business*

Service company controlled by registered holding company, *held*, retainable as reasonably incidental or economically necessary or appropriate to operation of principal electric utility system controlled by holding company.

APPEARANCES:

*John R. Quarles*, *James Vorenberg*, *Richard B. Dunn*, and *William D. Andrews*, for New England Electric System and its subsidiary companies.

*David N. Brackman*, *Herbert Baer* and *Edward G. Seferian*, for the Massachusetts Department of Public Utilities.

*Solomon Freedman*, *Aaron Levy*, *Frederick Zazove* and *William R. Nowlin*, for the Division of Corporate Regulation of the Securities and Exchange Commission.

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By Whitney, Commissioner

This is the final phase of proceedings instituted by us under Section 11(b)(1) of the Public Utility Holding Company Act of 1935 ("Act") for the purpose of determining the extent to which the electric, gas, and other operations of the holding-company system of New England Electric System ("NEES"), a registered holding company, may be retained under common control.

We previously found that the electric utility assets of the NEES subsidiaries meet the definition of a single integrated public-utility system,[1] and NEES has elected to retain those assets as its principal sys-

[1] *New England Electric System*, 38 S.E.C. 193 (1958).

tem. The chief remaining issue now before us is whether the gas utility subsidiaries of NEES, which concededly constitute a single integrated gas utility system as defined in the Act,[2] may also be retained as an additional integrated utility system under the standards prescribed in Section 11(b)(1) of the Act.

Hearings were held at which evidence in support of retention was presented by NEES and its subsidiaries ("respondents") and by the Department of Public Utilities of the Commonwealth of Massachusetts ("Massachusetts DPU") and evidence in opposition to retention was adduced by our Division of Corporate Regulation ("Division"). Proposed findings and briefs were filed, and we heard oral argument. Our findings are based on an independent review of the record.

*Description of the NEES System*

NEES is a holding company controlling seven electric utility subsidiaries and eight gas utility subsidiaries. It also owns thirty percent of the outstanding stock of Yankee Atomic Electric Company through one of its electric utility subsidiaries and all the common stock of New England Power Service Company ("NEPSCO"), which provides various

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[2] Section 2(a) (29) (B) of the Act defines an integrated gas utility system as ". . . a system consisting of one or more gas utility companies which are so located and related that substantial economies may be effectuated by being operated as a single coordinated system confined in its operations to a single area or region, in one or more States, not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation: *Provided,* That gas utility companies deriving natural gas from a common source of supply may be deemed to be included in a single area or region."

services to the entire system. The retail electric operations serve 824,000 customers in the states of New Hampshire, Massachusetts, Rhode Island, and Connecticut comprising a franchise area of about 4,600 square miles with a total population of over 2,300,000 people. As of December 31, 1958, the gross investment in electric plant and equipment was approximately $600,000,000 and gross revenues from sales of electricity in 1958 were approximately $143,000,000.[3] The NEES gas subsidiaries provide retail service to about 237,000 customers in Massachusetts only, in an area of 660 square miles with a population of approximately 1,032,000 people. Of this gas franchise area, about 494 square miles, or 75%, is also part of the franchise area of NEES' electric subsidiaries, and approximately 78% of the gas customers are also served with electricity by the NEES electric companies. The NEES gas subsidiaries and NEES' ownership of their common stock are as follows:

| Company | % Common Stock Ownership by NEES |
|---|---|
| Central Massachusetts Gas Company ("Central Massachusetts") | 100.00 |
| Lawrence Gas Company ("Lawrence") | 90.43 |
| Lynn Gas Company ("Lynn") | 93.76 |
| Mystic Valley Gas Company ("Mystic") | 99.41 |
| North Shore Gas Company ("North Shore") | 97.52 |
| Northampton Gas Light Company ("Northampton") | 100.00 |
| Norwood Gas Company ("Norwood") | 99.38 |
| Wachusett Gas Company ("Wachusett") | 100.00 |

[3] The basic figures in the record are for the year ended December 31, 1958, the latest year for which audited financial statements were available at the time of the hearings, and 1958 has been used as a test year for the purposes of these proceedings.

Most of these gas properties were acquired by NEES in the period from 1926 to 1931. As of December 31, 1958, the NEES investment in gross gas plant and equipment was approximately $56,300,000 and gross revenue from gas sales in 1958 was approximately $22,700,000. The bulk of the gas sold by the NEES subsidiaries is natural gas produced in the southern United States, principally Texas, and purchased from pipeline companies that deliver it to Massachusetts.[4] Each of the gas subsidiaries also owns and operates facilities for the production of manufactured gas for peak-shaving and emergency stand-by purposes.

After an attempt to sell the gas properties in the early 1950's which was not consummated because of the prospective purchaser's inability to obtain required financing, in 1952 NEES separated various aspects of the activities of the gas subsidiaries from those of the electric companies. It established a Gas Division with headquarters at Malden, Massachusetts,[5] to supervise the 8 gas companies. The executive head of the Gas Division is also president of each of the gas companies and the staff of that Division are all part-time employees of each of the gas companies, and the salaries of those persons are paid pro rata by those companies. The Gas Division has four functional departments—management, marketing and supply, operations, and merchandising—and provides centralized service to the gas companies

[4] Seven of the gas companies purchase natural gas from one pipeline, and the remaining company purchases such gas from another pipeline. About 98% of the natural gas is purchased from the first pipeline company.

[5] All of the gas companies are within 48 miles of Malden, except one which is 80 miles distant.

with respect to such matters as gas acquisition and distribution, engineering, sales promotion, and new business development. Each of the gas companies has a vice-president and general manager who is in immediate charge of the company and reports directly to the head of the Gas Division; the latter, in turn, is responsible to the NEES top management.

Other aspects of the gas and electric business have continued to be handled on a joint basis. Such joint activities include treasury and accounting services, meter reading, customer billing, labor negotiations and administration of employee programs, procuring insurance, purchasing operations, and joint use of office and other space and equipment. Some of these services are performed by NEPSCO on a contract basis with the individual system companies. NEPSCO's services include supervision of local accounting departments, preparation of tax returns and regulatory reports, and handling of rate, personnel and public relations matters. In 1958 NEPSCO's charges to the gas companies aggregated $317,000.

*Statutory Standards*

Section 11(b)(1) of the Act imposes requirements for geographic and economic integration which were designed to eliminate evils that Congress found to exist "when the growth and extension of holding companies bears no relation to . . . the integration and coordination of related operating properties."[6] Congress recognized that in the absence of clearly overriding considerations a utility system should have a management single-mindedly devoted to advancing the interests of its investors and consumers and not

[6] Section 1(b)(4) of the Act.

engaged, through the means of the holding company device, in operating other separate or competing utility or non-utility business. It accordingly laid down the basic requirement in Section 11(b)(1) that registered holding companies and their subsidiaries limit their operations to a single integrated public utility system and any other businesses reasonably incidental or economically necessary or appropriate to the operations of such system. Exemption from this requirement was provided in exceptional cases meeting specific geographic and economic tests. Under Clauses A, B and C of that Section, we must permit a holding company to continue to control one or more additional integrated public utility systems if we find that:

> "(A) Each of such additional systems cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system;
>
> "(B) All of such additional systems are located in one State, or in adjoining States, or in a contiguous foreign country; and
>
> "(C) The continued combination of such systems under the control of such holding company is not so large (considering the state of the art and the area or region affected) as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation."

It is well settled that gas properties and electric properties, since they pertain to different and competing utility businesses, do not constitute a single integrated public utility system,[7] and as noted NEES

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[7] See *Columbia Gas & Electric Corp.*, 8 S.E.C. 443, 462-63 (1941); *The United Gas Improvement Co.*, 9 S.E.C. 52, 77-83

concedes that its electric and gas properties constitute two separate integrated public utility systems. Since NEES has elected to retain the electric properties as its principal system, the gas properties can be retained as an additional system under NEES' control only if the tests of Clauses A, B, and C above are satisfied. There is no question under Clauses B and C. Since all the NEES gas subsidiaries are located within Massachusetts, the standard of Clause B is met. Also the Division acknowledges, and we find, that the size of the combined gas and electric operations is not so large as to raise any substantial question under the standards of Clause C with respect to the advantages of localized management, efficient operation, and the effectiveness of regulation. The issue remains, therefore, whether continued control by NEES of the gas companies is necessary to prevent the loss of substantial economies within the meaning of Clause A.

Clause A was intended to limit the retention of utility systems in addition to the principal system controlled by a holding company to situations where it could be shown that the additional systems were integrated in nature and "were so small that they were incapable of independent economic operation"[8]

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(1941); *The North American Co.*, 11 S.E.C. 194, 215-16 (1942), aff'd on other grounds *sub nom. North American Co.* v. *S.E.C.*, 133 F.2d 148 (C.A. 2, 1943); *Philadelphia Co.*, 28 S.E.C. 35 (1948), aff'd *sub nom. Philadelphia Co.* v. *S.E.C.*, 177 F.2d 720, 723 (C.A.D.C., 1949).

[8] Remarks of Senator Wheeler following pasage of the Act, 79th CONG., REC. 14479 (1935): "After considerable discussion the Senate conferees concluded that the furthest concession they could make would be to permit the Commission to allow a holding company to control more than one integrated system if the additional systems were in the same

and had a "real economic need" for management together with the principal system.[9] Congress was aware that some loss of economies would usually result from the separation of jointly controlled utility systems,[10] but considered that continued joint management should be permitted only where separation would entail a loss of economies which would be substantial in the sense that they were important to the ability of the additional system to operate soundly. As stated by the United States Circuit Court for the District of Columbia:

> "Substantial economies," means something different and, we think, something more than substantial savings in operational expenses. Congress could have said that the divorcement shall not be decreed if the controlling utility or the controlled utility show at a hearing that the cost to operate the latter separately from the former would be substantially greater. If the Act can be construed as meaning just that, then

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region as the principal system and were so small that they were incapable of independent economical operation. . . ."

[9] H.R. Rep. No. 1903, 74th Cong., 1st Sess., p. 71 (1935). See also *The North American Co.* v. *S.E.C.*, 327 U.S. 686, 696-97 (1946): "In essence [Section 11(b)(1)] confines the operations of each holding company system to a single integrated public utility system with provision for the retention of additional systems only if they are *relatively small . . . and unable to operate economically under separate management without the loss of substantial economies.*" (Emphasis added.)

[10] See Hearings before Committee on Interstate and Foreign Commerce on H.R. 5423, 74th Cong., 1st Sess. (1935), Pt. 2, pp. 1249, 1402-03, 1530-31, Pt. 3, pp. 2257-77, and before Committee on Interstate Commerce on S. 1725, 74th Cong., 1st Sess. (1935), p. 65.

> the severance ordered here is wrong. "Substantial economies" must mean, as was said in *North American Co.* v. *Securities and Exchange Commission*, 2 Cir., 133 F.2d 148, 152, "important economies." The required *importance* must relate to the healthful continuing business and service of the freed utility. But Congress was not so much concerned with the profit motive of utilities as with the evils that had become prevalent through combinations of utilities. It was first concerned with the wiping out of the evils which the practice of utility combinations had produced, and Congress only consented to dull the blade of its chosen weapon in proved hard cases. (Italics in original.)[11]

In light of the legislative background, as buttressed by court interpretation, demonstrating that Clause A was meant to provide for a limited exception to the general policy expressed in the Section, we have held that the clause must be strictly construed and that a registrant seeking to retain an additional system has the burden of showing by clear and convincing evidence that such additional system cannot be operated under separate ownership without the loss of economies so important as to cause a serious impairment of that system.[12]

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[11] *Engineers Public Service Co.* v. *S.E.C.*, 138 F.2d 936, 944 (C.A.D.C., 1943).

[12] *Engineers Public Service Co.*, 12 S.E.C. 41, 60 (1942); *Philadelphia Co.*, 28 S.E.C. 35, 45-47 (1948), aff'd *sub nom. Philadelphia Co.* v. *S.E.C.*, 177 F.2d 720 (C.A.D.C., 1949); *Middle South Utilities Inc.*, 35 S.E.C. 1, 11 (1953); *The North American Co.*, 11 S.E.C., 194, 208-9 (1942), aff'd on other grounds *sub nom. North American Co.* v. *S.E.C.*, 133 F.2d 148 (C.A. 2, 1943); *Cities Service Power & Light Co.*,

*Estimated Loss of Economies from Severance of Gas System*

In support of their position that severance of the gas subsidiaries from the NEES system would result in the loss of "substantial economies" within the meaning of Clause A, respondents rely essentially upon a study made for them by Ebasco Services Incorporated ("Ebasco"), management consultants with extensive experience in the utilities field, which showed that severance would bring an increase in operating costs. Based on Ebasco's supplemented study,[13] respondents' estimated increase in annual

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14 S.E.C. 28, 137 (1943); *The Middle West Corp.*, 15 S.E.C. 309, 318 (1944); *Cities Service Co.*, 15 S.E.C. 962, 984 (1944).

[13] The study as initially presented assumed that each of the gas companies would be operated separately, it being respondents' view that, notwithstanding the gas companies are presently operated as a single integrated public utility system, the fact that they might be disposed of individually or in groups made it proper to consider the increase in costs which would be incurred under individual operation. Following objections by the Division that the proper approach required the assumption that the gas companies would continue to be operated together as a single system, rather than separately, the study was supplemented so as to provide for a Central Organization for the eight gas companies after severance. The study, as thus modified, indicated the estimated increase in annual operating costs of the gas system after severance would be $329,400 less than the increase estimated on the initial assumption of eight separate gas companies without any Central Organization.

It would be inappropriate to give any weight to the estimates of increased costs to the gas companies on the assumption of separate operations by each of them after severance. Both we and the courts have held that the loss of economies to be considered under Clause A is that pertaining to the additional integrated system sought to be retained (See *Engineers Public Service Co.* v. *S.E.C.*, *supra* note 11 at 944; *The North Ameri-*

operating costs of the gas system after severance would be $1,165,600.[14]

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*can Co.* v. *S.E.C.*, *supra* note 12 133 F.2d at 152; *Philadelphia Co., supra* note 12, 28 S.E.C. at 52; *General Public Utilities Corp.*, 32 S.E.C. 807, 838-9 (1951)), and we find no basis for departing from this established interpretation of the Act in this case. Moreover, we noted in the *General Public Utilities* case at p. 835, note 33: "The severance study also estimated the 'loss of economies' upon the assumption that each of the gas divisions was a separate integrated public utility system. Since we have determined that the gas properties constitute a single integrated public-utility system, we have given no consideration to this aspect of the study."

Respondents' assertion that a sale of the gas properties as a single system may be difficult if not impossible to achieve is not borne out by the record and overlooks the fact that in 1951 NEES obtained three bids for its gas properties as a whole, which were then more extensive than those now held, even though as has been indicated the contract which was signed with the highest bidder was subsequently terminated because of the latter's failure to arrange necessary financing. Moreover, it fails to consider other methods of divestment of the gas system as a whole. Thus, NEES' stock holdings in the gas companies could be placed in a new company the stock of which could be sold or distributed as dividends to the NEES stockholders over an appropriate period of time.

[14] The study also estimated that the costs of the NEES electric subsidiaries would be increased after severance by $804,800 per year. However, such increase is not a factor which could justify retention of the gas system if it is found that the latter can be economically operated independently of NEES. *General Public Utilities Corporation*, 32 S.E.C. 807, 838-39 (1951). The thrust of the statute is the limiting of interstate utility holding company operations to a single integrated utility system managed exclusively in the interests of its own investors and consumers and the restricting of ownership or domination of such a system by interests principally engaged in other activities. The Act is not directed at preserving the benefits which the principal activity derives from

In analyzing the Ebasco estimate of increased costs to the gas system, it is necessary at the beginning to make a downward adjustment in the amount of $67,000, the amount by which NEPSCO's charges to the gas companies in 1958 would have been increased had a revised basis of payments authorized by us at the end of 1959 been in effect in 1958.[15]

We accordingly turn to the questions of whether the Ebasco estimate, thus reduced to $1,098,600, is an acceptable basis on which to determine the present issues and whether it indicates that the test of Clause A is met. The Division contends that the estimate is not valid because it attributes excessive amounts of expenses to the *pro forma* combined gas operations and that, even assuming increased costs as estimated, they do not represent the loss of substantial economies warranting retention of the gas properties under common control with the NEES electric system.

The Ebasco estimate is inadequately supported in a number of important aspects and leaves considerable doubts which respondents have not satisfactorily overcome in the record. Of the total estimated increase in the expenses of the gas companies after severance, $472,100 is attributed by Ebasco to so-called treasury and accounting costs, which comprise the categories of customer accounting, general ac-

the joint ownership with the other activities. Moreover, it may be noted that in any event the asserted $804,800 loss of economies to the electric system cannot properly be viewed as "substantial" in light of the fact that it is but 0.56% of that system's electric operating revenues and 0.76% of its electric operating revenue deductions before Federal income taxes.

[15] Under the revision approved in 1959, NEES's payroll and related expenses were transferred to NEPSCO and were allocated to the companies benefiting from the services according to a designated formula.

counting, machine accounting, stores accounting and miscellaneous services. The largest single item is with respect to customer accounting, as to which an increase in costs is estimated in the amount of $415,600 or approximately 40% of the total $1,098,600 estimated increase. In light of the fact that the supplemented Ebasco study, which assumed that the gas system would be operated on a combined basis, estimated the same increase in customer accounting costs as appeared in the original Ebasco study, which was based on the assumption that the companies would be operated separately, and in light of respondents' and Ebasco's failure adequately to explain why combined operations would not result in lesser amounts for such costs, we conclude that the $415,600 figure is overstated.

More specifically, one of the important items making up the estimated increase in the cost of customer accounting after severance is customer billing. Ebasco projected the gas billing costs on the basis of separate billing operations by each of the gas companies. Its estimate provides for the employment of additional personnel and rental of additional equipment by those companies to do their own billing.[16] At present, gas billing is done on a combined basis with one or more of the NEES electric companies in the case of each of the gas companies except Norwood, the smallest of the companies.[17] However, respondents have not

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[16] The exact cost attributable by Ebasco to the additional billing personnel and equipment in the case of each of the gas companies is not identified in the estimate, but in the case of Mystic and Lynn they would total $34,700.

[17] Wachusett and Central Massachusetts have their billing done by the NEES Central District Treasury Organization at Worcester. The billing for Lawrence is done jointly with that of Merrimack Electric Co. Lynn and Lynn Electric Company.

given any satisfactory reason why at least some form or forms of combined billing procedure could not be employed advantageously by the gas companies, in light of the fact that their aggregate of 237,000 customers is located in a relatively compact area.[18]

Also inadequately explained and casting doubt on the estimates of increases in customer accounting expenses is the disparity between the increases attribuated to the gas companies and those attributed to the electric companies. Thus, for example, in 1958 the cost of customer accounting jointly performed for Northampton and Northampton Electric Lighting Company was allocated $17,000, or $2.12 per customer, to the gas company, and $34,200, or $3.60 per customer, to the electric company; whereas under the *pro forma* estimates, the gas company's costs after severance would amount to $48,400, or $6.03 per customer, representing an increase of 184%, and those of the electric company would be $38,500, or only $4.05 per customer, an increase of 13%. Even accepting NEES' contention that customer accounting costs should be viewed together with the other treasury and accounting costs, a substantially similar disparity appears. Total treasury and accounting

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and Northampton and Northampton Electric Company also have joint billing operations for their respective gas and electric customers. Mystic's and North Shore's billing is done at Malden, together with the billing for Suburban Electric Company.

[18] The testimony of respondent's Ebasco witness clearly indicates that centralized billing is predominant in the utilities industry, and that savings would be effected thereby. However, although he expressed the opinion that central billing would not effect "too substantial" a saving for the severed gas companies, no attempt was made to determine whether, and the extent to which, such savings would be substantial.

payroll costs of Northampton, according to respondents' estimates, would increase by 85% to $89,300, or $11.13 per customer, while those of the Northampton Electric Company would increase by only 24% to $88,900, or $9.35 per customer. Again in the case of Lynn and Lynn Electric Company, which jointly serve approximately the same territory and a comparable number of customers, and which have done their treasury and accounting work jointly, in 1958 the payroll costs allocated to the gas company amounted to $228,300, or $5.58 per customer, and those charged the electric company were $64,000, or $8.02 per customer. Under respondents' estimates the *pro forma* costs would increase by 71% to $390,133, or $9.53 per customer, for the gas company and only by 22% to $445,323, or $9.81 per customer for the electric company. The record fails to indicate the validity of these disproportionate effects on the customer accounting and the total treasury and accounting costs of the gas and electric companies upon severance. These areas of expense, in general, are related to the number of customers served and not the type of utility business conducted.

In view of respondent's burden of proof and the absence of a persuasive explanation on the record, Ebasco's failure to consider employment of combined billing procedures and its inadequately explained disparate treatment of certain effects of severance on the gas and electric companies, respectively, substantially impair the credibility and preclude the acceptance of its estimate of a $472,100 increase in treasury and accounting costs and, in turn, of its over-all estimate of increased costs (of which that figure is a material part) in the determination of whether severance would result in a substantial loss of economies.

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Respondents contend that in addition to the estimated increased expenses to which they have assigned dollar amounts there will be other significant losses as a result of severance which are not measurable in dollars. They assert in particular that there would be a loss of experienced administrative, supervisory and long-range planning personnel and services. However, the Ebasco study purportedly estimated the costs of providing organizations for the gas companies which would supply appropriate performance and standards.[19] Moreover, even assuming there would be some "intangible" losses, they must be regarded as part of the over-all effects of severance which normally accompany any reorganization of operations and which Congress must have anticipated when it provided that, other than in exceptional cir-

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[19] The Central Organization for the gas companies provided for under the supplemental Ebasco study is estimated to have an annual cost of $574,000 and would include executive and supervisory officials and personnel. It would be headed by a president with an annual salary of $40,000, as compared to the $25,000 salary paid in 1958 to the President of the NEES Gas Division, who is also president of the eight gas subsidiaries. A new position of Executive Vice President would be created, with the incumbent, whose duties would include assisting the president and supervising the other executives, receiving a salary of $25,000. Like the NEES Gas Division, it would have three assistants to the president and a sales manager, with functions and salaries similar to those at present except that the latter's salary would be $17,500, representing an increase of $4,000 per year, and reflecting additional sales promotion duties which would be delegated to him by the president. Twelve additional employees would be provided to handle public and personnel relations and safety and purchasing matters. The salaries of these latter employees would total $87,000, approximately the same amount paid in 1958 as salaries to locally employed personnel and NEPSCO for similar services.

cumstances, separate utility systems should be under separate control. Further, we are unable to accept the suggestion that the NEES integrated gas system, the second largest gas utility operation in Massachusetts, would not be able to provide management and service comparable to that provided by other gas utilities in the state.[20] In that effort it would also have the benefit of the experience in unified gas operations gained by the Gas Division since its formation in 1952.

Even were we to accept the $1,098,600 estimate of loss of economies to the NEES gas companies, it would not lead us to conclude that such a loss is so substantial, when compared with the loss of economies involved in prior divestment cases and viewed in light of the objectives of the Act, as to warrant retention of the gas properties under common control with the NEES electric system. Although that amount is larger than the amounts involved in prior severance cases, we have previously pointed out that the test of the substantiality of the estimated loss is not in absolute terms but rather in relation to total

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[20] See *Cities Service Co.*, 15 S.E.C. 962, 982 (1944), where in rejecting a contention that deprivation of the services of a system service company would result in loss of substantial economies, we observed that:

> "to accept an estimate of present benefit from services rendered by system service companies as a measure of economies which would be lost as a result of independence requires us to assume that financial severance will cast operating units completely adrift, incapable of providing themselves with comparable benefits as cheaply either directly or through mutual arrangements with other operating units. We cannot make that assumption."

See also *The North American Company*, 11 S.E.C. 194, 210 (1942).

revenues, expense and income.[21] In the instant case, the amount of the estimated loss of economies would be equal to 4.83% of the gas system's operating revenues, 6.03% of operating revenue deductions (excluding federal income taxes), and 23.28% of gross income and 29.94% of net income before federal income taxes. These ratios are lower or not significantly higher than corresponding ratios of gas systems whose divestment we have required on the ground that the estimated loss of economies was not substantial within the meaning of Clause A.[22]

Respondents and the Massachusetts DPU argue that an increase in operating costs would have an exceptionally adverse impact in the case of the NEES gas subsidiaries and therefore should be viewed as more serious than an equal dollar amount of increases in other cases because of the highly competitive position of gas in relation to fuel oil in the Massachusetts area. They point out that natural gas is piped from Texas and the price is higher in the

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[21] *Philadelphia Co.*, 28 S.E.C. at 49; *General Public Utilities Corp.*, 32 S.E.C. at 837.

[22] Attached as an Appendix is a table which compares the adjusted Ebasco estimate of loss of economies to the NEES gas subsidiaries with the estimated losses in the prior cases where similar computations were made, in all of which we ordered divestment of the additional system. We do not attribute any comparability to the present case to the gross income and net income ratios of the gas properties of Jersey Central Power & Light shown in that table, which are substantially higher than those of the NEES gas group, because the gross income of Jersey Central's gas department prior to any severance adjustments was found to be so low as to represent an unusually low rate of return on the amounts invested in that property. See *General Public Utilities Corp.*, 32 S.E.C. 807, 837 (1951).

New England area than in any other part of the country, whereas oil is brought in by tanker and its price is virtually the same as or lower than in any other part of the United States. The chief market for gas in the NEES area is residential space heating, and Ebasco estimated that the annual cost of gas for heating a typical New England house is \$166, as compared with the cost of oil of \$173, whereas in other parts of the United States the differential ranges from \$27 to \$118 in favor of gas. It is contended that an increase in the cost of gas operations as a result of severance would force an increase in gas rates to customers, and that such an increase would impair the slight competitive advantage now held by gas.

However, even assuming that the described competitive conditions in Massachusetts will continue to prevail, despite efforts to improve the cost position of gas through such means as storage of off-peak natural gas, those conditions obtain generally throughout Massachusetts. There is no evidence that they do not affect in the same manner other independent gas utility companies in the state which nevertheless have been able to conduct their operations and, apparently, earn a fair return without the alleged advantages of common control with electric utilities by a holding company. The situation of the independent companies is different, respondents contend, because the opportunity for increased sales in the NEES gas service area is limited by a more moderate rate of economic growth, population increase, and suburban housing construction than in other parts of the state.[23] However, respondents

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[23] Respondents point out that between 1950 and 1960 the population in the NEES franchise areas increased by only

failed to show that, because of these factors, the impact of severance would be such that the combined NEES gas operations, which are larger than those of most of the other gas utility companies in Massachusetts, would be unable to compete effectively with oil, even though the nonaffiliated companies are able to do so.[24]

Moreover, the operating ratio[25] of the NEES gas system after severance of 76.41% would be more favorable or only slightly higher than that of nine nonaffiliated Massachusetts gas companies selected by respondents for comparison that have no joint electric operations, which have a composite ratio of 79.14% and median and mean ratios of 74.87 and 76.35%, respectively.[26] In light of the fact that the operating

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11% while in the franchise areas of seven independent Massachusetts gas companies used by the Division for comparison (see p. 13, *infra*) the increase was 18%.

[24] Of 12 nonaffiliated Massachusetts gas companies which respondents selected for comparison with NEES, only one exceeded the NEES gas utility system in size of gross plant, gross annual revenues, and number of customers. It may also be noted that the NEES gas system is substantially larger than systems we have ordered divested in prior cases, such as those whose pertinent data are set forth in the Appendix table. We found that several of those systems in turn were larger than companies that had demonstrated conclusively their ability to operate effectively free of holding company control. See *Philadelphia Co.*, 28 S.E.C. 35, 46-7 (1948); *Middle South Utilities, Inc.*, 35 S.E.C. 1, 11 (1953).

[25] "Operating ratio" as used above is the percentage of total operating revenue deductions (other than depreciation, amortization of conversion costs, and Federal income taxes) to total operating revenues.

[26] The nine independent Massachusetts gas companies and their operating ratios are: The Berkshire Gas Co., 74.06%;

ratio of the NEES gas companies, even considering Ebasco's estimated increased costs, would still be substantially favorable in comparison with the independent Massachusetts companies, we would be entering the realm of speculation at this time to assume that rate increases would ensue from severance. Especially is this so in view of our finding that these increased cost estimates, on which respondents and the Massachusetts DPU rely in stating that gas rates would have to be increased upon severance, are overstated.

We also find no merit in respondents' contention that in order to avoid reduction of gas net earnings after severance, gas operating revenues would have to be increased by additional revenue of approximately $1,500,000, consisting of $1,098,600 to offset the estimated increased costs plus about $400,000 to offset, on a two-dollar for one-dollar basis, the asserted nonavailability to the gas companies of an estimated $200,000 of tax reductions presently resulting from joining in the consolidated income tax return filed by the NEES system. The test of Section 11(b)(1) governing the retainability of additional public-utility systems is not based upon reduction of net earnings upon severance but rather solely upon whether the increased operating costs occasioned by severance are "substantial." With respect to the claimed nonavailability of consolidated tax savings, we have held on prior occasions that any such saving is not related to any operational function of retention of control and is not an appropriate

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Boston Gas Co., 82.5%; Brockton Taunton Gas Co., 74.59%; Buzzards Bay Gas Co., 73.77%; Fall River Gas Co., 77.31%; Haverhill Gas Co., 74.87%; Lowell Gas Co., 75.75%; Springfield Gas Light Co., 74.65%; and Worcester Gas Light Co., 79.64%.

factor upon which to determine retainability of an additional system.[27] In addition, it does not appear that a gas holding-company system that would emerge after severance would not be able to secure all or substantially all of the tax benefits now available to the gas companies under NEES ownership. Moreover, respondents did not show any reason why the consolidated debt ratios (including the effect thereon of NEES' own corporate debt) that now appertain to the NEES gas companies and affect the system's consolidated income tax liability would not also be imputed to the new gas holding-company system.

Respondents have also argued that in reaching the conclusion in prior cases that estimated losses of economies were not substantial we considered that separation of the management of the gas or other properties of the additional system from that of the principal system would result in offsetting advantages. They assert that there would be no such advantages in separation of the NEES gas companies because, as a result of the creation of the NEES Gas Division in 1952, the benefits that flow from centralized and separated operation of the gas business have already been achieved.

We cannot accede to the view that such a separation of the gas from the electric operations has been effected as to secure the kind of single-minded management for each that would obtain upon actual divestment. Although the NEES Gas Division handles sales and promotional activities and various other matters for the gas subsidiaries separately from the electric companies, final authority on all important

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[27] *Philadelphia Co.,* 28 S.E.C. 35, 73 (1948); *Cities Service Co.,* 15 S.E.C. 962, 985 (1946).

matters rests in the top NEES management. The basic competitive position that exists between gas and electric utility service within the same locality[28] is affected by such vital management decisions as the amount of funds to be raised for or allocated to the expansion or promotion of each type of service. It is asserted by respondents and the Massachusetts DPU that NEES has made all such decisions with full regard for the needs of the gas companies, has vigorously promoted the gas business, and has not suppressed that business in favor of the NEES electric business. The Division points to the fact that of twelve independent Massachusetts gas companies used by respondents for comparison with NEES, seven which the Division considered comparable had substantially higher mcf sales and revenues per customer than the NEES gas companies[29] and their cus-

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[28] See *Philadelphia Co.*, 28 S.E.C. at 48; *Engineers Public Service Co.*, 12 S.E.C. 41, 58 (1942).

[29] The NEES gas companies sold 44.2 mcf per customer in 1958 while sales of the 7 independent gas companies compared to NEES were 78.8 mcf per customer, or 78% greater. In 1959 the NEES sales were 51.5 mcf per customer compared with sales of 83.7 mcf per customer by the independent group, or 63% greater.

Respondents object to the Division's elimination of Boston Gas Co. in making its comparisons. The Division considered that company not to be comparable to the NEES gas companies because it remained a distributor of lower btu manufactured or mixed gas until 1960, whereas the NEES companies distributed natural gas only. The difference in the nature of the gas sold is a material factor affecting comparability, but even were Boston Gas Company included the over-all comparison would not be substantially changed. Boston Gas Company's total gas sales were greater than those of the NEES group, being 57.0% mcf per customer compared with 44.2 mcf for NEES in 1958, and 62.3 mcf per customer compared with

tomers pay less per mcf of gas consumed than the NEES gas customers.[80] It must be recognized that *prima facie* this disparity in favor of the independent companies, if it is at all meaningful, tends to indicate that the independent gas operations have been more effective than those of NEES gas management. Although the Massachusetts DPU argues that much of this disparity is caused by the difference in population characteristics of the NEES franchise areas and those of the independent companies because the latter had a more rapidly growing suburban residential population, no specific demonstration of the existence or extent of such a causal relation was presented. In any event, it is clear that the determinations respecting the basic interests of the gas companies are made by NEES officials who occupy a dual position in which they must weigh the needs and objectives both of those companies and of the electric companies which represent the principal and most profitable business of the NEES system. On the basis of the facts presented in this case we can-

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51.5 mcf for NEES in 1959, although in the area of domestic gas sales, Boston Gas sold less than the NEES group, its sales being 34.0 mcf per customer compared with 34.9 mcf for NEES in 1958 and 37.4 mcf compared with 56.1 mcf in 1959.

Revenue from gas sales by the NEES companies in 1958 was $95.44 per customer compared with $135.19 per customer for the 7 independent companies. In 1959 the comparable figures were $104.49 for the NEES group and $142.10 per customer for the independent group.

[80] The cost of gas to NEES customers in 1958 was $2.16 mcf sold compared with $1.72 per mcf for the independent group, and in 1959 NEES customers paid $2.03 per mcf while customers of the independent gas companies paid only $1.70 per mcf.

not conclude that a management solely interested in and devoted to the gas operations would not be able to advance them more effectively.

Respondents and the Massachusetts DPU further contend that in deciding whether substantial economies would be lost by severance of the gas companies we must accord great if not conclusive weight to that Department's views in favor of the retention of the gas properties within the NEES system. They argue that the Act reflects a Congressional recognition that the desirability of combined gas and electric operations is essentially a local question and indicates a policy of accommodation to the desires of local regulatory authorities on that question. They point to the fact that we have in prior cases granted exemptions from the Act under Section 3 and permitted separation from our jurisdiction pursuant to reorganization plans filed under Section 11(e) of companies having combined gas and electric operations. They cite in particular *Northern States Power Company*[31] which referred to those cases and expressly followed the recommendation of the local regulatory authorities in granting such an exemption.

We of course agree that the views of interested regulatory authorities should always be carefully considered, and have done so in this case. However, we do not view the statutory pattern as contemplating that the standards of Section 11 should yield to the views of state or local authorities whenever the properties whose joint retainability under that Section is in question are gas and electric properties. Section 8 of the Act, to which the Massachusetts DPU points particularly, requires state approval of acquisitions of gas and electric properties to be jointly owned or

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[31] 36 S.E.C. 1 (1954).

operated if state law prohibits or requires approval of such combination. However, it merely serves to prevent circumvention of express state restrictions against such acquisitions by imposing a condition of state approval even though acquisitions are otherwise permissible under the standards of the Act, and does not relate to the divestment of properties under the policy embodied in Section 11(b)(1). It must be read together with the provisions of Sections 9 and 10 which impose other conditions to acquisitions that apply even if all state laws are met and which are directed toward and embrace the standards of Section 11. Section 10(c) expressly provides that we shall not approve an acquisition which is unlawful under Section 8 or detrimental to the carrying out of the provisions of Section 11 or which we are unable to find would tend to promote the economical and efficient development of an integrated public utility system. It is clear that the economic and geographic integration objectives of Section 11 were uppermost in Congress' mind in adopting Sections 9 and 10,[32] and that Section 8 was not intended to permit any relaxation of those objectives. There is significantly no reference in Section 11 to considerations of state or local policy, as there is in various other sections of the Act,[33] and the federal policy embodied in that Section is clearly paramount.[34]

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[32] See S. Rep. No. 621, 74th Cong., 1st Sess. (1935), pp. 29-30; H. R. Rep. No. 1318, 74th Cong., 1st Sess. (1935), p. 15.

[33] *Cf.* Sections 6(b), 7(g), 8, 9(b)(1), 9(b)(2), 10(f) and 20(b).

[34] See *Public Service Commission* v. *S.E.C.*, 166 F.2d 784, 787 (C.A. 2, 1948), *cert. denied* 334 U.S. 838.

We do not take the view that the Act expresses a federal policy against combined gas and electric operations as such. The Act is concerned with interstate holding company activities and within that area it prescribes tests of retainability which must be met. In the cases where we granted exemptions or otherwise released jurisdiction despite the existence of combined gas and electric operations, the holding companies involved did not come within that area because they and their subsidiaries were entirely intrastate or were primarily operating companies or because under the Section 11(e) reorganization plan which was to be effected no interstate holding company system with combined operations would survive. In exemption situations we are not required to determine whether the requirements of Clauses A, B and C of Section 11(b)(1) are satisfied; where the applicable geographic and operational requisites are otherwise met our inquiry with respect to the combined operations aspect is limited to determining whether it affirmatively appears that such operations would be detrimental to the public interest or the interests of investors or consumers. The *Northern States* case involved an application by a holding company which was also an operating company for an exemption from the Act pursuant to Section 3(a)(2), which provides for the exemption of a holding company and its subsidiaries where the holding company is predominantly a public utility company. We found that the predominance test and geographic requirements of Section 3(a)(2) were met, and it was on the question of whether the record showed that the exemption would have a detrimental effect that we considered the favorable views of the local authorities and found that they together with other data presented by the applicant overcame the contention of

the Division to the contrary which was supported by a study that we found to be unpersuasive.[35]

In the present case the issue is whether respondents, an interstate holding company system headed by NEES, have made the requisite showing under Clause A of Section 11(b)(1) that the losses from severance of the gas companies would be substantial. As has been stated, respondents rely on the Ebasco study. The Massachusetts DPU which has made no study itself, states that the estimates contained in the study conform to the losses of economies that its own familiarity with the NEES system would lead it to anticipate, and it joins in Ebasco's opinion that such losses would be substantial. We have seen that the study is deficient with respect to its principal item of estimated loss, thus materially impairing its persuasiveness and making it unacceptable. We have also been unable on the basis of the record before

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[35] Respondents and the Massachusetts DPU also cite *Middle South Utilities, Inc.*, 35 S.E.C. 1 (1953), where in proceedings under Section 11(b)(1) the City of New Orleans recommended retention by New Orleans Public Service, Inc., a subsidiary of Middle South whose principal business was electric, of gas and transportation properties and we did not order divestment of those properties. However, one of the factors presented by the City was that it had purchase option rights which would have been lost by severance. It was partly because of that situation that we decided not to order divestment at that time but rather to defer decision on that issue, which is still pending. See S.E.C. 26th Annual Report, 133 (1960). In that same opinion we ordered separation of the gas properties of Louisiana Power & Light Company, another subsidiary, from its electric properties, and we subsequently refused to revoke or modify that order despite the position of the Louisiana Public Service Commission that independent operation of the gas system would increase expenses. *Middle South Utilities, Inc.*, 36 S.E.C. 383 (1955).

us to accept the contention that there would be other significant losses not reflected in the dollar estimates or to find that the gas companies could not be soundly and economically operated independently of NEES, even assuming the validity of the estimates in the Ebasco Study. On the basis of our consideration of the entire record as to the nature and extent of the claimed losses, we cannot find that respondents have met their burden of showing that the test of Clause A for the retention of the gas properties under the control of NEES is satisfied.

*Conclusions*

In view of the foregoing we shall direct NEES to take appropriate action to divest itself of its interests in the system's gas properties.

The remaining issue in these proceedings relates to the retainability by NEES of its interest in NEPSCO. Since it appears that the operations of NEPSCO are reasonably incidental and economically necessary and appropriate to the operations of the integrated electric utility system of NEES, the proceedings will be dismissed insofar as they relate to the retainability of that company.

An appropriate order will issue.

Chairman CARY and Commmissioners WOODSIDE and COHEN join in the above opinion.

Orval L. DuBois
Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION
March 19, 1964

ORDER REQUIRING DIVESTMENT OF NON-RETAINABLE PROPERTIES AND PERMITTING RETENTION OF SERVICE COMPANY

In the Matter of

NEW ENGLAND ELECTRIC SYSTEM

and

ITS SUBSIDIARY COMPANIES
RESPONDENTS

File No. 59-102

Public Utility Holding Company Act of 1935

The Commission having instituted proceedings pursuant to Section 11(b)(1) of the Public Utility Holding Company Act of 1935 with respect to New England Electric System ("NEES") and its subsidiary companies to determine what action, if any, should be required to limit the operations of the system to a single integrated public utility system and to such additional systems and other businesses as are retainable under the provisions of Section 11(b)(1) of the Act;

The Commission having previously found that the electric utility properties of NEES constituted a single integrated public utility system within the definition set forth in Section 2(a)(29)(A) of the Act and having dismissed the proceedings relating

to that issue while retaining jurisdiction over the remaining issues (38 S.E.C. 193 (1958));

A public hearing having been held after appropriate notice, at which evidence was adduced with respect to the remaining issues whether the gas utility assets of NEES are retainable by NEES as an additional integrated utility system and whether NEES may retain its interest in New England Power Service Company as a business whose operations are reasonably incidental or economically necessary or appropriate to the operations of the integrated electric utility system; and briefs and proposed findings and conclusions having been filed, and oral argument having been heard; and

The Commission having considered the record, and having this day issued its Findings and Opinion herein; on the basis of such Findings and Opinion

It Is Ordered, pursuant to Section 11(b)(1) of the Act, that the New England Electric System dispose of the gas utility properties presently controlled by it and terminate its relationship with the following companies by disposing of or causing the disposition, in an appropriate manner not in contravention of the Act or the Rules, Regulations or Orders of the Commission thereunder, of all interests, direct or indirect, which it holds in those companies:

Central Massachusetts Gas Company
Lawrence Gas Company
Lynn Gas Company
Mystic Valley Gas Company
North Shore Gas Company
Northampton Gas Light Company
Norwood Gas Company
Wachusett Gas Company

It Is Further Ordered that the proceedings be, and they hereby are, dismissed insofar as they relate to the issue of whether the operations of New England Power Service Company are reasonably incidental and economically necessary and appropriate to the operations of the integrated electric utility system of New England Electric System and are retainable as such.

It Is Further Ordered that jurisdiction be, and it hereby is, reserved to take such further steps as are necessary and appropriate to carry out the terms of this order.

By the Commission.

Orval L. DuBois
Secretary

| | Engineer Public Service Co. | | | | The North American Co. | | Philadelphia Co. | |
|---|---|---|---|---|---|---|---|---|
| | Gas Properties of Gulf States Utilities Co.—1940 | | Gas Properties of Virginia Electric and Power Co.—1940 | | Gas Properties of The St. Louis County Gas Co.—1942 | | Gas Group—1946 | |
| | Amount | Per cent of estimated loss of economies to: | Amount | Per cent of estimated loss of economies to: | Amount | Per cent of estimated loss of economies to: | Amount | Per cent of estimated loss of economies to: |
| Operating revenues | $638,711 | 6.58 | $1,057,000 | 3.38 | $2,748,770 | 5.85 | $16,656,560 | 3.00 |
| Operating revenue deductions (excluding Fed. inc. taxes) | $444,006 | 9.46 | $ 735,294 | 4.86 | $2,009,757 | 8.01 | $13,197,846 | 3.79 |
| Gross income (before deducting Fed. inc. taxes) | $201,594 | 20.85 | $ 317,890 | 11.25 | $ 742,027 | 21.68 | $ 3,565,357 | 14.03 |
| Net income (before deducting Fed. inc. taxes) | $166,402 | 25.25 | $ 168,412 | 21.23 | $ 661,110 | 24.34 | N.A. | N.A. |
| Estimated loss of economies claimed | $ 42,024 | | $ 35,750 | | $ 160,900 | | $ 500,328 | |

| | General Public Utilities Corp. | | | | Middle South Utilities, Inc. | | NEES | |
|---|---|---|---|---|---|---|---|---|
| | Electric Properties of Northern Pennsylvania Power Co.—6/30/49 | | Gas Properties of Jersey Central Power & Light Company—6/30/49 | | Gas Properties of Louisiana Power & Light Company—1954 | | Gas Properties of 8 Subsidiaries Combined—1958 | |
| | Amount | Per cent of estimated loss of economies to: | Amount | Per cent of estimated loss of economies to: | Amount | Per cent of estimated loss of economies to: | Amount | Per cent of estimated loss of economies to: |
| Operating revenues | $4,027,081 | 1.44 | $4,714,958 | 4.87 | $5,264,186 | 5.18 | $22,752,270 | 4.83 |
| Operating revenue deductions (excluding Fed. inc taxes) | $3,046,479 | 1.90 | $4,235,661 | 5.42 | $4,112,285 | 6.63 | $18,207,191 | 6.03 |
| Gross income (before deducting Fed. inc. taxes) | $ 981,980 | 5.90 | $ 479,477 | 47.84 | $1,151,901 | 23.68 | $ 4,718,864 | 23.28 |
| Net income (before deducting Fed. inc. taxes) | $ 855,101 | 6.77 | $ 202,582 | 113.24 | N.A. | N.A. | $ 3,669,931 | 29.94 |
| Estimated loss of economies claimed | $ 57,890 | | $ 229,398 | | $ 272,816 | | $ 1,098,600 | |

N.A. Not Available

## APPENDIX C

# UNITED STATES COURT OF APPEALS
## For the First Circuit

No. 6332

NEW ENGLAND ELECTRIC SYSTEM, ET AL.,
PETITIONERS

*v.*

SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

On Petition for Review of an Order of the Securities and Exchange Commission

Before ALDRICH, *Chief Judge*, SWEENEY, *Chief Judge*, and WYZANSKI, *District Judge*

*John R. Quarles*, with whom *Richard B. Dunn*, *Richard W. Southgate*, *John J. Glessner, III*, and *Ropes & Gray* were on brief, for petitioners.

*David Ferber*, Solicitor, with whom *Phillip A. Loomis, Jr.*, General Counsel, *Ellwood L. Englander*, Assistant General Counsel, *Martin D. Newman*, Attorney, and *Solomon Freedman*, Director, Division of Corporate Regulation, Securities and Exchange Commission, were on brief, for respondent.

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OPINION OF THE COURT

June 4, 1965

ALDRICH, *Chief Judge*. This is a petition seeking to review and set aside a divestment order of the Se-

curities and Exchange Commission pursuant to section 11(b)(1) of the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79k(b)(1), requiring the petitioner, New England Electric System (NEES) to dispose of its gas utility properties by terminating its relationship with its eight subsidiary gas companies. The ultimate question in the case, which the Commission resolved against NEES, was whether divestiture would cause the loss of "substantial economies" within the meaning of the cited section.

Briefly, NEES is a registered holding company controlling, at the time of the hearing, fourteen electric utility subsidiaries and eight gas subsidiaries, with some 824,000 retail electric customers in the states of New Hampshire, Massachusetts, Rhode Island and Connecticut, and some 237,000 retail gas customers in Massachusetts. Seventy-eight percent of its gas customers are also served by the electric companies. Except for certain peaks and emergencies the gas distributed is natural gas supplied by pipe line companies from the southern United States. The gas companies have separate offices and management, but their top officers are responsible to the top officials of NEES. There was a lengthy hearing before an examiner at which NEES sought to show that the cost of divestment to the electric system would be $804,000 annually, and to the gas system, if operated as a single unit after severance, $1,098,000.[1] The Commission held, *inter alia*, that the financial effect upon the electric system was not a relevant inquiry, but that if it was it was not significant. This we do not reach.

[1] NEES' actual figure was $1,165,000, but the Commission reduced this by $67,000 as a result of a "revised basis of payments" authorized by it. NEES does not presently dispute this adjustment, but points out that the reverse adjustment must be made to the estimated electric system losses.

It also held, which we do reach, that the claimed financial consequences to the gas system were not substantial as it construed the statute, but that if they were they had not been adequately proven.

Basic to its decision, as the Commission recognized at the outset of its opinion, is the meaning of the Act and the standards which it imposed. Briefly, section 11(b)(1) required divestiture unless NEES could satisfy the provisos or exceptions [2] contained in subparagraphs, or clauses, (A), (B) and (C). Clauses (B) and (C) were admittedly met. Clause (A) reads as follows:

> (A) Each of such additional systems cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system;

Before considering whether the Commission's interpretation of this clause was correct we must determine what its interpretation was. At the beginning of its opinion the Commission stated that to prevent divestiture NEES must show,

> that the additional systems were integrated in nature and "were so small that they were incapable of independent economic operation" and had a "real economic need" for management together with the principal system. Congress was aware that some loss of economies would usually result from the separation of jointly controlled utility systems, but considered that continued

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[2] The Commission uses the word "exceptions," and criticizes NEES' word "provisos." NEES' distinction, as we read it, was in response to a heavy burden of proof which the Commission sought to attach to exceptions. See fn. 4, *infra*.

> joint management should be permitted only where separation would entail a loss of economics which would be substantial in the sense that they were important to the ability of the additional system to operate soundly. [Footnotes omitted.]

The Commission then quoted at length from a decision by the Court of Appeals for the District of Columbia,[3] from which it drew the conclusion that clause (A) required a "showing by clear and convincing evidence[4] that such additional system cannot be operated under separate ownership without the loss of economies so important as to cause a serious impairment

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[3] *Engineers Public Service Co.* v. *S.E.C.*, 138 F. 2d 936, 944 (1943). This case is extensively relied on in the Commission's opinion without noting that certiorari was granted, 322 U.S. 723 (1944), and the decision subsequently vacated as moot. 332 U.S. 788 (1947). This omission was remedied in its brief. We do not know whether the view of the majority, or the dissent of Judge Soper which accords with ours, would have ultimately prevailed.

[4] The Commission has been criticized before for using this phrase, the court allowing it to pass, however, on the ground that it meant no more than the fair preponderance of the evidence, the ordinary burden of proof. *Philadelphia Co.* v. *S.E.C.*, D.C. Cir., 1949, 177 F. 2d 720, 725. We do not agree. This phrase has a well recognized meaning, and is applied in special cases, such as fraud, *Lackawanna Pants Mfg. Co.* v. *Wiseman*, 6 Cir., 1943, 133 F. 2d 482, 486, or mistake, *Philippine Sugar Estates Devel. Co., Ltd.*, v. *Philippine Islands*, 1918, 247 U.S. 385, 391, as applied in *Aetna Ins. Co.* v. *Paddock*, 5 Cir., 1962, 301 F. 2d 807, 811. The Comission is to be criticized for continuing to use this language, which by its tone suggests to laymen, as well as to lawyers, a heavy burden. We suspect, from other statements in its opinion, that it accurately revealed the Commission's approach. If so, in any future proceedings the Commission should readjust its receptivity as well as its phraseology.

of that system." Lastly, at the end of its opinion, the Commission concluded that on the record it was unable "to find that the gas companies could not be soundly and economically operated independently of NEES, even assuming the validity of * * * [its] estimates."

Thus the statutory phrase, "cannot be operated as an independent system without loss of substantial economies," was said to mean, "incapable of independent economic operation;" "important to the ability * * * to operate soundly;" "so important as to cause a serious impairment of that system;" and "could not be soundly and economically operated."

In *Middle South Utilities, Inc.*, 35 S.E.C. 1, 11 (1953), its most recent decision cited in its opinion for the support of its interpretation, the Commission ordered a divestment because it had not been shown that it would "cause the serious economic impairment of the system *or* that the gas properties could not operate effectively and efficiently under separate ownership." [Italics supplied.] Since presumably the Commission did not intend to voice simultaneously two different standards we read the word "or" as introducing an explanation or equivalency. Essentially this second *Middle South Utilities* phrase is the sole standard that the Commission adopts in its brief before us.

Also may be noted the Commission's statement, in refutation of one of NEES' contentions, that "other independent gas utility companies in the state * * * nevertheless have been able to conduct their operations and, apparently, earn a fair return without the alleged advantages of common control with electric utilities by a holding company."

Taking the record as a whole we find its brief accurate, and that the Commission's interpretation is

that a loss is not "substantial" unless it would render impossible "economical or efficient operation."[5]

As to the correctness of this interpretation we have not considered before the meaning of clause (A), and there is no uniformity of judicial view elsewhere. It is true that in *North American Co.* v. *S.E.C.*, 1946, 327 U.S. 686, 696-7, the court referred to section 11 (b)(1) as permitting retention only of "relatively small [companies] * * * unable to operate economically under separate management without the loss of substantial economies * * *." This was a passing summary, and did not purport to be an exact characterization. The precise meaning was not relevant to the constitutional questions then under consideration, and even if the court's language is not considered ambiguous we do not take it as an attempt to resolve possibly intricate questions of construction. We turn, therefore, to other considerations.

Although we do not regard the legislative history as determinative, we begin there as the Commission makes much of it. Its principal reliance is upon the concluding remarks of Senator Wheeler on the floor after the bill had finally passed both branches. Senator Wheeler stated, *inter alia*, that the act permitted a holding company to retain more than one integrated system only when the additional systems "* * * were so small that they were incapable of independent

[5] NEES suggests there is no practical difference between preventing economical operation and bankruptcy. The Commission does not address itself to this question. We assume it believes there to be a difference, but except to the extent suggested in fn. 7, *infra*, we cannot find from its opinion what the difference is, or, more important, what is the standard by which uneconomical operation is determined. The very serious problem which this would present we do not reach because we disagree with the Commission's basic interpretation.

economical operation." 79th Cong. Rec. 14479 (Aug. 24, 1935). We may note, at the outset, that only by a most generous interpretation is this statement part of the legislative history. Having come afterwards, it could not have affected the voting. The best reason for considering it as evidence of Congressional intent, see *United States* v. *United Mine Workers*, 1947, 330 U.S. 258, 279-80; *Duplex Printing Press Co.* v. *Deering*, 1921, 254 U.S. 433, 477; *cf. State Wholesale Grocers* v. *Great Atlantic & Pacific Tea Co.*, D.C.N.D. Ill., 1957, 154 F. Supp. 471, 485, *rev'd on other grounds*, 258 F. 2d 831, *cert. den.* 358 U.S. 947, is accordingly absent.[6] Furthermore, coming from the leading Congressional advocate of strict separation, see *e.g.*, 79 Cong. Rec. 1525, Feb. 6, 1935; *id.*, 4903 (radio address of April 2, 1935); *id.*, 14470, Aug. 24, 1935 (remarks of Senator Norris), it would seem natural to regard it, at that stage of the proceedings, as a self-serving declaration. To the cynically minded it would seem to have been merely a post-contest attempt to raise the score, recapture what had been lost in the compromise with the House discussed *infra*, and to serve, just as is now being sought, to influence

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[6] See Hart and Sacks, The Legal Process: Basic Problems in the Making and Application of Law (tent. ed. 1958) 1285:

"The views of individual members of the legislature as to the meaning of a statute which were not officially communicated to the legislature prior to its enactment are not competent to be considered in determining the meaning which ought to be attributed to the statute."

Nor could it have invited a presidential veto, since the President was a known advocate of a strong bill. See 79 Cong. Rec. 3425-26, 3469-70, March 12, 1935 (Message to Congress); *id.* at 9042, June 11, 1935 (letter to Senator Barkley and Senator Wheeler); *id.* at 14164, Aug. 22, 1935 (letter to Representative Rayburn).

subsequent history. The best that should be said for Senator Wheeler's statement under these circumstances is that it is not to be given the weight to which it might have been entitled if made at another time.

The other pieces of legislative history related in the Commission's brief are a quotation from remarks by Representative O'Connor speaking "of 'a little power plant in Florida' or 'a little plant in Oklahoma' (79 Cong. Rec. 14168, Aug. 22, 1935)" and one from Representative Cooper, "who had opposed the motion, [and] had referred to systems retainable under Clause (A) as 'unprofitable companies * * * too weak to stand alone' (*id.* at 14165-14166)." Examination of Representative O'Connor's full statement rebuts the economic implication the Commission wishes us to attach to the word "little." It is evident that the remarks were addressed to geographical aspects, the absentee landlordism condemned in clause (B). It is true that Representative Cooper was speaking of clause (A). But it seems apparent that as an opponent of the bill he was strategically engaged in blackening it. According to him the compromise was no compromise whatever, a position demonstrably unsound. His interpretation of particular clauses must be read in that light. *Labor Board* v. *Fruit & Vegetable Packers & Warehousemen, Local No. 760*, 1964, 377 U.S. 58, 66.

A much more pertinent characterization of the phrase "substantial economies" is found in the statement of the House Managers attached to the conference report recommending passage of the compromise draft, that the retention of additional systems was to be permitted where there was a "real economic need." H.R. Rep. No. 1903, 74th Cong., 1st Sess., 71. This language, however, is itself ambiguous. Obvi-

ously there would be a real economic need to prevent a loss that would preclude efficient or effective operation. But there could also be said to be a real economic need to avoid any truly sizable financial loss notwithstanding the utility's ability to absorb it and remain efficient in some absolute sense.[7] For reasons we now come to we believe the statute is to be given this more general meaning.

The declaration of legislative objectives is found in section 1(b). Subsection (1) thereof concerns improper accounting practices, capitalization, etc., that may injure investors. Subsection (2) refers to excessive charges and other effects of transactions among companies within a holding company system. It also, together with subsection (3), refers to impediments occasioned by the holding company device to state regulation. We quote in full the remaining subsections, which declare the public interest to be adversely affected,—

> (4) when the growth and extension of holding companies bears no relation to *economy of*

[7] We have already commented upon the Commission's failure to enunciate any standard beyond this broad generalization of economy or efficiency. See fn. 5, *supra*. Possibly its views are partly implied by the points made in its opinion when assuming that an annual loss of $1,098,000 had been adequately established. The first was that while this amount is larger, absolutely, than losses required to be accepted in any previous case, it is not larger relatively. Secondly, that the loss would be only 23.28% of gross income, and 29.94% of net income before federal income taxes. (The word "only" is ours.) Third, that there are "other independent gas utility companies in the state which nevertheless have been able to conduct their operations and, apparently, earn a fair return * * * and * * * compete effectively. * * *" Finally, that it "would be entering the realm of speculation at this time to assume that rate increases would ensue from severance."

*management and operation* or the integration and coordination of related operating properties; or

(5) when in any other respect there is *lack of economy of management and operation* of public-utility companies *or lack of efficiency and adequacy of service* rendered by such companies, or lack of effective public regulation, or lack of economies in the raising of capital. [Italic supplied.]

Pausing here we note in the italicized phrases two concepts, economy of management and operation, and efficiency (and adequacy) of service. The word "or" in clause (5) is clearly used in the disjunctive. This separate meaning is emphasized when we come to section 11(b)(1) clauses (A) and (C), *infra.* It will be sufficient to note here, for both present and future purposes, that the Commission has taken the word "efficient" from this use in connection with service and joined it with the phrase "economy of management and operation," and has then built out of the combination the concept that until a loss of economy and efficiency is shown to be total there has been no loss of substantial economies under clause (A) within Congressional concern. We may note, also, an omission which we take seriously, that on the sole occasion that the Commission quoted clause (4) it substituted asterisks for the phrase we have italicized, and, although the legislative meaning of economies is the specific matter under consideration, has never referred to it. Clause (5), likewise, is never mentioned.

The definitions of "integrated public-utility systems" are found in section 2(a)(29). Subsection (A) defines an integrated electric system as one which, *inter alia,* "may be economically operated as a single

interconnected and coordinated system." Subsection (B) defines a gas system as where, *inter alia,* "substantial economies may be effectuated by being operated as a single coordinated system." During argument we inquired the reason for this difference. No suggestion was forthcoming. The only reason apparent to us is that in order for electric companies to constitute an integrated public utility system they must meet a technical requirement not applicable to gas companies seeking to qualify as an integrated system. Unlike gas companies, *General Pub. Util. Corp.*, 1951, 32 S.E.C. 807, 834-35, electric companies must be "physically interconnected or capable of physical interconnection." Where this requirement is met, so that actual interchanges of power could be made to meet power requirements at different points in the system, it was enough for Congress that the system as a whole "may be economically operated as a single interconnected and coordinated system." Assuming the other qualifications were met electric companies would not have to prove that system ownership would be cheaper than independent ownership, probably because this could safely be assumed where there would be a sharing of power.

Coming to section 11(b), the primary provision, subsection (1) requires that holding companies be restricted to a single integrated public utility system except when subclauses (A), (B) and (C) are satisfied. For clarity we quote in full.

> (A) Each of such additional systems cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system;

(B) All of such additional systems are located in one State, or in adjoining States, or in a contiguous foreign country; and

(C) The continued combination of such systems under the control of such holding company is not so large (considering the state of the art and the area or region affected) as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation.

These exceptions to section 11(b)(1) were added as a result of a compromise with the House. The original Senate bill had flatly restricted holding companies to a single integrated system. S. 2796, 74th Cong., 1st Sess. (1935). The House sought to permit as many systems as were consistent with the public interest. See H.R. Rep. No. 1318, 74th Cong., 1st Sess. 17 (1935). The Commission's then chairman objected that this would be intolerably indefinite. 79 Cong. Rec. 10838 (July 9, 1935); see also H.R. Rep. No. 1318, *supra*, at 45. Clauses (A), (B) and (C) were proposed as a compromise to establish "definite and concrete circumstances" where retention of more than one system would be allowed. Statement of House Managers, *supra*, at 70.

It is basic to the Commission's position that the phrase "substantitl economies which can be secured by the retention of control" in clause (A) is fundamentally different from "substantial economies [that] may be effectuated by being operated as a single coordinated system" in section (29)(B).[8] Such a con-

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[8] The Commission is committed to this, and expressly so recognizes in its brief, because it rejected certain important evidence offered by NEES solely on the ground that the eight gas companies were conceded to be "a single integrated system." Since the Commission could not, either in good con-

tention, of course, is opposed to the common principle that the same words in different portions of an act are presumed to have the same meaning. In this case they are exactly the same.[9] To overcome the presumption calls for an affirmative showing.[10]

Furthermore, we find the Commission's interpretation of clause (A) opposed to the initial statement of the purposes of the Act, *supra*, the tenor of which was that holding companies had been found uneconomical to investors and to the public. It is not inconsistent with this to say that systems which do not offend in this respect, or in the other respects defined in clauses (B) and (C), should be continued instead of broken up, and that occasioning a loss of impressive proven economies was not the Congressional purpose. This was a business reorganization act designed to produce

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science or in law, accept as a concession a matter so fundamental, not only to the present proceedings, but for the future, if it were contrary to the fact, it stands that the Commission feels that saving $329,400 annually by integrating the eight gas companies is effectuating substantial economies under section (29) (B), but that $1,098,600 annually is not substantial economies under clause (A).

[9] The Commission's brief goes to some length in emphasizing the word "loss" in section 11(b) (1) (A). Sections 2(a) (29) (B) and 11(b) (1) (A) are not incomparable because the former speaks in terms of effectuating and the latter in terms of losing. The important comparison is the word "effectuated" in the one section and "secured" in the other. Both relate directly to "substantial economies."

[10] In a special effort to make this showing counsel argues that there is a policy in the Act against an electric utility system being combined with a gas system. The short answer to this is that neither the Act, nor the Commission itself, says so. Since, however, counsel's argument is extensive we will reply in kind, but in order not to prolong this footnote we will do so in an appendix, *infra*.

a healthier economic structure in a vital industry. It established what, in the opinion of Congress, accomplished the best overall conditions. At the same time, Congress remained receptive to what, in a particular instance and within the limits established by clauses (B) and (C), might be affirmatively shown to be a more economical arrangement. We hold that clause (A) called for a business judgment of what would be a significant loss, not for a finding of total loss of economy or efficiency. *Louisiana Pub. Serv. Comm'n v. S.E.C.*, 5 Cir., 1956, 235 F.2d 167, *rev'd on jurisdictional grounds*, 353 U.S. 368.

We are confirmed in this view by the fact that not only do clauses (B) and (C) contain additional conditions of retention, so that clause (A) need not be interpreted so as to cover the entire Congressional intent, but that these other clauses relate back fully to counterparts of the declarations of purpose made in section 1(b), and the attempts to effectuate those purposes through the definitions made in section 2(a) (29), *supra*. Clause (A) would do the same were it not for the special restricted meaning that the Commission seeks to give it. The Commission, in other words, has attached to "substantial economies" in this one particular place a special meaning that nothing in the Act points to, and which, in fact, destroys its symmetry.[11]

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[11] Drawing an equivalence between the proviso contained in clause (A) to section 11 and the corresponding requirements for an integrated gas system under section 2(a)(29)(B) nullifies no technical requirements in the definition of an integrated gas system because there are none. The definition of an integrated electric system under section 2(a)(29)(A) does contain some technical requirements, as has been pointed out, but these, also are not nullified by our interpretation of clause (A) since it remains stricter than section 2(a)(29)(A)'s re-

It might not be inappropriate to conclude with the quotation with which the Commission began a section of its brief. "As was stated [the brief says] in the report of the National Power Policy Committee: '[I]ntensification of economic power beyond the point of proved economies not only is susceptible of grave abuse but is a form of private socialism inimical to the functioning of democratic institutions and the welfare of a free people.' * * * H. Doc. No. 137, 74th Cong., 1st Sess. 4 (1935), appended to S. Rep. No. 621, 74th Cong. 1st Sess." We cannot think that "proved economies," any more than "substantial economies," mean anything other than economies which in ordinary business parlance and by ordinary business standards are of a substantial nature, considering, of course, the size of the companies to which the economies relate.[12] Clearly that was what was meant elsewhere in the Act. If in clause (A) Congress meant, instead, "cannot be operated efficiently as an independent system" it could readily have done so not only more clearly, but in fewer words.

The Commission's only answer is "the policy of the Act." We think the policy of the Act is to be found in the whole Act, not in one part. NEES has the burden of proving that it falls within an exception. This is enough, without a forced reading into that exception of some special meaning.

We regret the length of this discussion. Since, however, we find the Act not only consistent, but entirely responsive to analysis, we feel such analysis

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quirement that the electric system "may be economically operated."

[12] In this case the claimed losses are over 23% of gross income. See fn. 7, *supra*.

called for in fairness to those persons, whether investors or consumers,[13] who must absorb perhaps a million dollars a year (quite apart from over $800,-000 allegedly lost to the electric system) which the Commission feels insubstantial.

The Commission having applied the wrong standard, its decision must be reversed unless on the record there could have been no finding in NEES' favor on the appropriate standard. We think clearly there could have been. NEES' case was based essentially upon a study made for it by Ebasco Services, Inc., (Ebasco), a management consultant which the Commission found possessed extensive experience in the utilities field. No rebuttal evidence, other than some exhibits, was offered on behalf of the Commission, which grounded its rejection of the report, to the extent that it did reject it, solely on criticism of the report's conclusions in the light of NEES' evidence or its own expertise. Its specific criticisms related to that portion of the report which dealt with certain costs totalling $472,100 or, more specifically, for the most part, customer and accounting costs included therein, for which the Ebasco estimate was $415,600. The first criticism concerned billing. The circumstances were these. Ebasco's original study was made on the assumption that the gas companies would be individually managed. On this hypothesis it naturally assumed that each company would conduct separate customer billing. When the Commission took the position that the gas companies constituted a single

[13] The Commission's finding it significant that it was insufficiently shown that this loss would require an increase in rates "at this time," fn. 7, *supra,* not only disregards the fact that the cost of doing a utility business normally is passed on to consumers eventually, but the fact that one of the purposes of the Act was to benefit legitimate investors.

integrated system and should be sold as such, Ebasco was required to reduce its estimate by the amount attributable to operating the gas companies individually rather than as a unit. It made no reduction with respect to customer billing.

On this subject NEES called three witnesses. One Quig, a representative of Ebasco with ample qualifications, testified to certain accounting savings that could be effected if the gas companies were operated collectively rather than individually. He stated, however, that Ebasco would not recommend, at least at the outset, centralization of certain matters, including billing; that a continuing study might show that further centralization would prove useful, but that it was by no means clear that economy lay in that direction, and that it would depend on such factors as business growth, new developments in mechanization, etc. Subsequently one Dalbeck, the principal officer of NEES' gas division, testified that it was conceivable that centralized billing might be effected to some degree, but that in his opinion it was not really important costwise; that he had made many studies of customer accounting procedures and had never found any real economies in centralization of billing. Thereafter one Johnson, an Ebasco representative with particular experience in customer accounting, testified that a detailed study would have to be made, which Ebasco had not done; that based upon his experience he had considered centralized billing for the combined operation and had made the judgment that there would be no economy, or at least "any substantial savings." The witness was cross-examined at length and showed a wide knowledge not only of specialized mechanical equipment in this area and the problems involved, but also of the particular practices of a large number of

named utilities in various parts of the country. He recognized that in many instances centralized billing prevailed, but continued to express doubts as to how much was saved thereby.

The Commission's response to this was to point out that some of the NEES gas companies presently combined their billing with the electric companies in their areas. This matter had been explained by NEES' witnesses, who pointed out, *inter alia*, the duplication of customers, which would not exist in the case of gas companies operating alone. The Commission concluded, however, that NEES had not "given any satisfactory reason why at least some form or forms of combined billing procedure could not be employed advantageously by the gas companies, in light of the fact that their aggregate of 237,000 customers is located in a relatively compact area."

We have serious doubts as to the extent that the Commission is entitled to disregard an opinion on a matter obviously requiring expert, specialized knowledge with no further evidence before it than what had been considered by the accepted expert. *Cf. United Shoe Mach. Corp.* v. *Industrial Shoe Mach. Corp.*, 1 Cir., 1964, 335 F. 2d 577, 579, *cert. den.* 379 U.S. 990; *Security-First National Bank* v. *Lutz*, 9 Cir., 1963, 322 F. 2d 348, 355; *Alvary* v. *United States*, 2 Cir., 1962, 302 F. 2d 790, 794; *Cullers* v. *Commissioner*, 8 Cir., 1956, 237 F. 2d 611, 616. This is not a matter on which a body having such broad jurisdiction as the Commission can have detailed expertise upon which to base affirmative findings. Compare *Market St. Ry.* v. *Railroad Commission*, 1945, 324 U.S. 548, 560. Without finally passing upon this point, since the case must go back in any event, we suggest that on this record the maximum the Com-

mission was warranted in inferring was that the difference in costs between separate and combined billing would not, if significant at all, constitute a sizable portion of the total added billing expense.

This brings us to what was the added billing expense, and hence the amount of error attributed to the Ebasco report because of its failure to assert the saving which, in the Commission's opinion, could be effected by having centralized billing. The Commission concluded merely that Ebasco's failure caused the estimate to be "overstated." It did not concern itself with discovering even what were the total increased billing costs, let alone the portion (obviously not the whole) which might be saved if centralized billing were adopted. It did find that the increased billing costs estimated for two of the eight gas companies, billing singly after divestiture, was $34,700 for the two. These companies covered more than half of NEES' gas customers. On a pro rata basis this would make the total billing increase for all companies $60,000. While doubtless such a projection is not precise, it seems significant that the Commission was not sufficiently interested to make any at all. Under the circumstances we do not think it unreasonable for us to point out that while the Commission was purportedly criticizing a cost estimate of over $400,000, strictly it was speaking of perhaps $60,000, only a portion of which could have been overstated.

We might have more sympathy with some, but not all, of the Commission's criticism of certain other alleged accounting disparities. Frankly, we are not sufficiently versed, nor do we find the record sufficiently helpful, to permit our analyzing them in every detail. However, it has not been contended that, even cumulatively, they remove from the Ebasco $472,000 cost estimate many sizable items.

After discussing the above matters the Commission said,

> In view of respondent's burden of proof and the absence of a persuasive explanation on the record, Ebasco's failure to consider employment of combined billing procedures and its inadequately explained disparate treatment of certain effects of severance on the gas and electric companies, respective, substantially impair the credibility and preclude the acceptance of its estimate of $472,100 increase in treasury and accounting costs and, in turn, of its over-all estimate of increased costs (of which that figure is a material part) in the determination of whether severance would result in a substantial loss of economies.

If this constitutes a finding that the deficiencies which the Commission believes it has found are so serious that the Commission was entitled to reject the balance of the report from that very fact, we cannot agree. The doctrine of "*falsus in uno, falsus in omnibus*," so far as it has any value, ordinarily applies to cases of deliberate falsehood. See 3 Wigmore, Evidence § 1013 (3d ed. 1940). The Commission has not suggested, and we see no possible basis for suggesting, that the discrepancies it complains of indicate bias or dishonesty. Absent a finding that the errors found are related to, or infect, other matters not directly discredited, if the "*falsus in uno*" doctrine, or a corollary, is to be used on any further basis to impeach an expert's report, it must be shown that the errors are so serious that they indicate substantial carelessness, or otherwise impugn the expert's qualifications. See *e.g.*, *Hoag* v. *Wright*, 1903, 174 N.Y. 36, 43; 66 N.E. 579, 581. Again, the Commission made no such findings. If there was a ground for them it has not been

suggested. Indeed, the Commission demonstrated its confidence in Ebasco elsewhere by accepting its cost estimates as the basis for concluding that the gas companies constitute an integrated system.

On the record there is a large, residual showing in the Ebasco report. Even at minimum it is $1,098,000 minus some fraction of $472,000. However, we do not think it presently appropriate for us to consider whether such minimum showing meets our interpretation of "substantial economies." We do state, however, that on remand the Commission must address itself to this problem by making specific findings, and not content itself with general conclusions. One illustration of this will suffice. The Commission states in its brief that it "had the right to consider competitive advantages of separation in offsetting alleged losses of economies." We do not question this. What we do question is the Commission's failure to find or articulate any specific or approximate financial benefit that such a change would occasion. Free competition, as the Act recognizes is normally beneficial. It is not necessarily so, nor in any assumed amount. The various automotive divisions of General Motors seem to do very well. More close to home, the Massachusetts Department of Public Utilities, which voices no apparent criticism of a number of combined local gas and electric companies within the Commonwealth, affirmatively appeared in opposition to the Commission's proceeding in the present case. The Commission states that the Department's views have been "carefully considered," but it goes no further. If the Commission is of opinion that substantial gains will accrue to the gas system by placing it in competition with the electric companies rather than, in part, under the same roof, specific findings should be made,

and not just a general reference to the advantages of competition. This is particularly called for where the evidence shows that NEES has made a special effort to obtain for its gas system many of the benefits of independence.

*Decree will be entered vacating the order of the Commission and remanding for further action not inconsistent herewith.*

## APPENDIX

In the Commission's brief counsel argues that section 11(b) embodies a federal concern with use of the holding company form to combine a gas system with an electric system.. There are several answers to this. In the first place, it is too specialized an approach. The meaning of this section and of sub-clauses (A), (B) and (C) must be the same whether the principal system and the additional systems are of like nature or are different. "Substantial economies," in other words, should have the same connotation in the one case as in the other.

Secondly, nowhere in the Act is there a condemnation of the retention of gas and electric systems, provided the tests contained in clauses (A), (B) and (C) are met. To the contrary, section 8 prohibits a holding company's acquisition of gas and electric utilities serving the same territory, where state law prohibits combined gas and electric operations, without express approval of the state commission. If anything, this is a negative pregnant, as the Commission has recognized and the legislative history makes clear. See *Northern States Power Co.*, 1954, 36 S.E.C. 1, 8; S. Rep. No. 621, 74th Cong., 1st Sess., 29-30; H.R. Rep. No. 1318, *supra*, at 14-15; Report of National Power Policy Committee, H.R. Doc. No. 137, 74th Cong., 1st Sess. 10 (1935), appended to S. Rep. No. 621, *supra*, at 59; Hearings Before House Committee on Interstate and Foreign Commerce on H.R. 5423. 74th Cong., 1st Sess. 330 (1935) (statement of Rep. Rayburn). How far such an inference may be carried in the light of the fact that section 10(c), which prescribes the standards for acquisitions, expressly incorporates the retention standards, and requires further that an acquisition tend toward the development of

an integrated system, may be questioned. *Cf. American Water Works & Elec. Co.*, 1937, 2 S.E.C. 972, 983 & n. 3; *Columbia Gas & Elec. Corp.*, 1941, 8 S.E.C. 443, 462-63; *American Gas & Elec. Co.*, 1946, 22 S.E.C. 808, 815. But at the least we find neither there nor elsewhere in the Act a general policy of opposition to gas and electric company joinder.

Nor, if the matter could be thought to be illuminated by administrative practice, has the Commission previously made such an interpretation, nor does it now. In its opinion the Commission stated, "We do not take the view that the Act expresses a federal policy against combined gas and electric operations as such." Counsel's attempt to explain this away by saying the Commission's phrase "as such" meant simply that the Commission was disclaiming interest when the interstate holding company form was not employed, attributes to the Commission the banality that it was not claiming jurisdiction in those cases where obviously it does not have it. We believe the Commission was saying something more than this, and that counsel, in the brief is merely seeking some new ground to support the Commission's result.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1967

No. 305

SECURITIES AND EXCHANGE COMMISSION,
*Petitioner,*

*v.*

NEW ENGLAND ELECTRIC SYSTEM ET AL.,
*Respondents.*

ON A PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

## BRIEF FOR RESPONDENTS IN OPPOSITION

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### OPINION BELOW

The opinion of the Court of Appeals for the First Circuit on the judgment sought to be reviewed is reported at 376 F.2d 107.

### QUESTION PRESENTED

The "basic question" stated in the Petition — whether the court below misapprehended the standard laid down by this Court for interpreting the "substantial economies" test under Section 11(b)(1)(A) of the Holding Company Act,[1] and improperly shifted the burden of proof from the holding company to the Commission (Pet. 2)[2] — is not raised by the record. The Petition in no way questions the standard of "serious impairment" as stated by this Court and the court below, and there is now no definitional dispute. As to the application of this standard and the burden of proof, the

[1] Public Utility Holding Company Act of 1935, 49 Stat. 820 (1935), 15 U.S.C. §79k(b)(1)(A) (1964).

[2] "Pet." refers to the Petition of the Securities and Exchange Commission including its appendices which reproduce the opinions of the court below and the Commission's Findings and Opinion.

court below explicitly stated that the holding company has the burden of proving loss of substantial economies under a stringent standard (Pet. 22); and nothing in its opinion even suggests that the burden of proof should be shifted from the holding company to the Commission.

The Petition also states three subsidiary "specific questions" as facets of the "basic" question (Pet. 3). None of these (as more fully discussed at pages 10-12 below) appears to be raised by the record or to be appropriate for consideration by the Court at this time.

The Respondents[3] say that the basic issue in the case is whether the court below, after review of the entire record, correctly held that the Commission in its Findings and Opinion has not indicated that it has adequately examined the evidence and applied its expertise to the particular facts and circumstances disclosed thereby and has not adequately stated its reasoning and conclusions.

## STATEMENT OF THE CASE

The Respondents are dissatisfied with the Petition's "Statement" (Pet. 4) in the following respects:

1. The Statement omits the crucial holding of the court below, based on its review of the entire record, as to the quality of the Commission's analysis of the evidence and its use of expertise in this case:

> "Even without the burden of proving likely demise,[4] petitioner's [NEES'] burden is, as the Court said, to meet

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[3] The Respondents are New England Electric System ("NEES") and subsidiaries.

[4] The Commission took a position before the Court of Appeals which indicated that it understood that the test of "loss of substantial economies" would be met only if the separated system would be "unable to stand by itself" (Pet. 20-21, 38). The court below carefully analyzed and then rejected this position, stating that a test based on mere ability to survive would read out of the Act the phrase "without the loss of substantial economies", and would distort this Court's approval of the words "serious impairment" (Pet. 21-22). The Petition does not take issue with that conclusion.

'a much more stringent test' than that of a probable significant loss. But, if the standard to be applied to petitioner is stringent, so is the level of analysis and expertise to be exercised by the Commission. We have, only after a fresh review of all the evidence in the light of this most stringent practical standard,[5] concluded that the Commission's opinion does not reveal that application of both reason and experience to facts which merits endorsement as the responsible exercise of expertise." (Pet. 22).

2. The Statement omits the circuit court's reasons for its holding that the Commission erred in its rejection of the entire Ebasco Report (a study of the effects of severance prepared by Ebasco Services, Inc.) and in its related conclusion that no losses had been proved. The court's reasons were the following:

(i) Even though, as the Petition notes (Pet. 6), the court did "not necessarily criticize the Commission for its skepticism in the specifics" (Pet. 24), it nonetheless concluded that "even taken together these items [the Commission's reasons for rejection] constitute at most a basis for reducing the estimated figure by some amount, not for concluding that no increased costs have been proved" (Pet. 24); and

(ii) "In fact, the record here demonstrates conclusively that *some* increased costs are inevitable — the only doubt possible concerns the amount." (Pet. 24). This conclusion the Petition apparently does not challenge.

3. The Statement makes no mention of the Commission's alternative reliance (assuming the losses were proved) on precedents and ratios taken without analysis from other cases, nor of the court's careful exposition of the very limited relevance of those precedents and ratios and of the

[5] The words "most stringent" are italicized in the Petition's reproduction of the court's opinion (Pet. 22) but are not italicized in the report. See 376 F.2d at 111.

Commission's failure to evaluate their comparability or meaning in this case (Pet. 29, 31). The court said that it did not "think that the Commission's obligation, which is at the root of the respect to which its expertise is entitled, is satisfied by the invocation of largely irrelevant ratios or other data concerning other companies, at other times, in other areas, facing possibly different conditions." (Pet. 31). The Commission's error, the court below said, was its failure to evaluate the effect of the anticipated losses "on the economic health of the particular [NEES] companies involved, in their particular circumstances." (Pet. 30).

4. The Petition states that the Commission found that other gas systems in Massachusetts "operate profitably" (Pet. 7), and says moreover that they are "thriving" (Pet. 11). The Findings and Opinion has no such finding. The closest the Commission came to suggesting successful operation was to say that other gas utility companies in Massachusetts "have been *able to conduct* their operations and, *apparently,* earn a fair return. . . ." (Pet. 59. Emphasis added.). The evidence in the record made it abundantly clear that all gas distribution companies in Massachusetts are remote from their source of supply and are in heavy competition with oil (Pet. 25). The court stated that:

> ". . . we can only conclude on the present record that all gas in New England operates on, as one witness testified, a small cushion. The significance of this is not negated by observing that non-NEES companies in Massachusetts seem to be surviving, for the focus must be on the specific characteristics of the NEES companies, the only ones affected by the Commission's order." (Pet. 27-28).

5. The court below did not hold, as the Statement suggests it did (Pet. 7), that the Commission had to determine whether the projected rate of return of the NEES gas companies operating independently would be sufficient to attract

the new investment necessary for the system's survival and growth. The court, "without pretending to define the one true test" (Pet. 30), listed that as one of several important economic considerations which it thought might be relevant factors for the Commission to consider when applying its expertise to determine the impact the losses would have on the particular companies involved (Pet. 30-31). In this connection the court pointed out that the Commission had failed even to discuss the fact that the projected rate of return for the NEES gas companies would be significantly below the average of the independent companies' "apparently fair" rate of return (Pet. 29), and also that the Commission's comparison of operating ratios (the ratio of costs to revenues cited by the Statement (Pet. 7)) is "irrelevant" (Pet. 30 n.6).

6. The Petition makes no reference to the holding of the court below that the burden of persuasion to which the holding Company may properly be held by the Commission is "a fair preponderance of the evidence" rather than a special standard of "clear and convincing evidence" of the kind traditionally imposed in civil cases involving such matters as fraud, and also in denaturalization and expatriation cases, and, more recently, deportation proceedings (Pet. 24 n.3, 77 n.4).[6] The Petition does not raise this issue and presumably accepts the ruling of the court below.

7. The Statement overstates the scope of the ruling of the court below with respect to the weight to be attributed by the Commission to the possibility of benefits from increased competition between gas and electricity. The court below held that the likelihood of such benefits "is precisely the sort of empirical judgment that the Commission is best qualified to make in light of its expertise" (Pet. 33), and it read this Court's opinion as saying that the Commission may "take that judgment into account as justifying a stringent test of

[6] See Woodby v. Immigration & Naturalization Serv., 385 U.S. 276, 285 n. 18 (1966); McCormack, Evidence § 320 (1954).

'substantiality'." (Pet. 33). The court then said that having established that stringent standard, unless it finds (as it has in a significant number of other divestment cases[7]) that the company to be divested has been suppressed for the benefit of its affiliates or that some definable particularized benefit will accrue from divestment, the Commission should confine itself to a quantitative analysis of the substantiality of the proved losses (Pet. 33-34). Since the Commission had found neither suppression nor any particularized offsetting benefit to be gained from severance, the court concluded that the Commission was "improperly attributing independent significance to the generalized competitive advantages" (Pet. 34). Were the Commission not required to make supporting findings, its judgment would be "unreviewable" (Pet. 32). That, the court concluded, was not this Court's intent (Pet. 32-33).

## ARGUMENT

**1. In its present posture, this case involves numerous evidentiary and factual questions and is not appropriate for the Court's review.**

The important legal question presented by this case has already been decided by the Court. 384 U.S. 176 (1966). What remains involves evidentiary and factual questions which would require the examination of thousands of pages of testimony and exhibits, and which because of the lack of essential findings and statement of reasons by the Commission could not be finally resolved by the Court on the basis of the record as it now stands.

Following the remand from this Court, the court below carefully reexamined the entire record and concluded that the Commission had not adequately examined the evidence

[7] Engineers Pub. Serv. Co., 12 S.E.C. 41, 58 (1942) (abuses in expense allocations); Cities Serv. Power & Light Co., 14 S.E.C. 28, 66 (1943) (neglect); North American Co., 18 S.E.C. 611, 620-21 (1945) (electric expansion at expense of gas); Commonwealth & Southern Corp., 26 S.E.C. 464, 490 (1947) (suppression of gas).

and applied its expertise, and had not adequately stated its reasoning and conclusions. The court found, for example, that the Commission's rejection of the Ebasco Report was contrary to conclusive evidence in the record (Pet. 24); that the Commission's Findings and Opinion failed even to discuss "obviously important data" (Pet. 29); and that the Commission relied instead on "the invocation of largely irrelevant ratios or of other data concerning other companies, at other times, in other areas, facing possibly different conditions." (Pet. 31).

Such a review of the record and testing of the Commission's findings in light of the substantial evidence in that record, taken as a whole, is precisely the function of judicial review which this Court and the Administrative Procedure Act have directed the Courts of Appeals to perform. "Whether on the record as a whole there is substantial evidence to support agency findings is a question which Congress has placed in the keeping of the Courts of Appeals." *Universal Camera Corp.* v. *NLRB*, 340 U.S. 474, 490-91 (1951). See *FTC* v. *Standard Oil Co.*, 355 U.S. 396, 401 n. 6 (1958); 5 U.S.C. §706 (Supp. II, 1965-66) (Administrative Procedure Act as codified by Public Law 89-554, 80 Stat. 393); Section 24(a) of the Public Utility Holding Company Act of 1935, 49 Stat. 834 (1935), as amended, 15 U.S.C. §79x(a) (1964).

This court does not grant certiorari to review evidence and discuss specific facts, and by its own decisions, its power to review the correctness of the application of the standard of substantial evidence in light of the entire record "ought seldom to be called into action." *Universal Camera Corp.* v. *NLRB, supra* at 490; *United States* v. *Johnston,* 268 U.S. 220, 227 (1925). The Court "will intervene only in what ought to be the rare instance when the standard appears to have been misapprehended or grossly misapplied." *Universal Camera Corp.* v. *NLRB, supra* at 491. This is because the Court, if it does review, will do "no more on the issue of insubstantiality than decide [whether] the Court of Ap-

peals has made a 'fair assessment' of the record." *FTC* v. *Standard Oil Co., supra* at 401.

This case is by no means one for the invocation of the rare and unusual step of this Court's review of the evidence in the entire record. The evidence is lengthy, complex and detailed. It has twice been completely reviewed by the Court of Appeals for the First Circuit.[8] The opinions of that court conclusively demonstrate that it made a fair assessment of the record, and the Petition does not contend otherwise.

**2. The court below has not misapprehended this Court's standard nor has it shifted the burden of proof.**

As already noted, the Petition does not question the circuit court's affirmation of the "serious impairment" standard laid down by this Court. Nor can it be said, based on the whole record, that the Court of Appeals has misapprehended the standard of substantial evidence. Rather, the court has quite properly required that the findings of the Commission be reasonably consistent with the substantial evidence in the record as a whole as applied to the statutory standard laid down by this Court (Pet. 24-25, 91-94), and sufficiently articulated and particularized to enable the reviewing court to determine whether the Commission has indeed applied its expertise in this case. See *Secretary of Agriculture* v. *United States,* 347 U.S. 645, 653-54 (1954); *Burlington Truck Lines, Inc.* v. *United States,* 371 U.S. 156, 167 (1962); and 5 U.S.C. §557 (Supp. II, 1965-66) (Administrative Procedure Act as codified by Public Law 89-554, 80 Stat. 387).

The basic contention of the Petition appears to be that the court below has required the Commission to bring forward its own evidence with respect to the economies to be lost,

[8] In all, five judges sitting on the Court of Appeals for the First Circuit have now reviewed the record in this case and have all concurred in that court's conclusions.

thereby shifting the burden of proof (Pet. 2, 8-9). This alleged misapprehension on the part of the court below, the Petition states, "inverts the scheme of the Act" (Pet. 9), "resolved all doubts in favor of retention" (Pet. 10, 12), requires the Commission "to remedy the deficiencies in the holding company's proof" (Pet. 10), and will leave the Commission's administrative resources "sorely strained" (Pet. 12).

If this is the contention of the Petition, it is clearly erroneous. The directive of the court below was not that the burden of proof should be shifted to the Commission or that the Commission's staff, which was a party to the hearing, should have adduced additional evidence or indeed any evidence at all. The court's requirement was instead that the Commission itself should adequately analyze, and in its Findings and Opinion adequately state its analysis of, the relevant evidence (Pet. 24-25, 29); that it should "address the considerations relevant to the ultimate issue it is required to resolve" (Pet. 27) and that through reasonably specific findings and conclusions by the Commission there should be "communicated" to the reviewing court the fact that, and the manner in which, the Commission has exercised its expertise (Pet. 31).

This is a normal and necessary standard of administrative practice; it represents the implementation, not the misapprehension, of this Court's opinion. The importance of the care and thoroughness required of the Commission by the court below is emphasized by this Court's standard of "serious impairment." The line is now drawn so close to the point of probable business failure that not only does it make the holding company's burden of proof a difficult one to carry, but it also makes the risk more substantial that a divestment order based on erroneous findings and broad assumptions rather than individual consideration will result in economic disaster (Pet. 27).

### 3. The Petition's three subsidiary questions are not raised by the record and are not appropriate for review.

The Petition lists three specific questions as facets of the basic question (Pet. 3). The Respondents submit that these questions are not raised by the record and are not appropriate for the Court's review at this time.

#### (i) The court below did not make the Commission's consideration of benefits of independent operation conditional on a finding of specific dollar value.

The Petition's first specific question is whether the Commission may consider offsetting advantages of independent operation without attempting to fix a specific dollar value therefor (Pet. 3). The Petition implies that the court below answered this question in the negative and thus imposed a requirement impossible to comply with (Pet. 14). What the court actually decided is something quite different.

First, as noted in item 7 at pages 5 and 6 above, the court affirmatively approved the Commission's reliance on its general experience in assuming that some benefits from independence are always likely to be realized, and the Commission's taking that assumption into account, without any quantitative evaluation, in justifying a stringent test of "substantiality" (Pet. 33).

Second, the court noted that the Commission had made no finding of offsetting advantages in this particular case (Pet. 33), but had instead apparently offset the proved losses on the basis of "generalized competitive advantages" (Pet. 34). While holding that the general conclusion can have no independent significance in an individual case, the court took pains to provide for any case in which the Commission finds a specific identifiable benefit of separation (Pet. 33, 94). In such a case, there is nothing in the court's opinion which requires, as the Petition suggests (Pet. 3, 14),

that the Commission attempt "to fix a specific dollar value" (Pet. 3); its obligation is rather, as the court said, to establish "its best estimate" (Pet. 30). The defect in the Commission's treatment of anticipated benefits of separation was, in the court's view, "the Commission's failure to find or articulate any specific or approximate financial benefit that such a change would occasion" (Pet. 94).

Unless the Commission is held to a reasonable standard of analysis, evaluation and articulation with respect to the benefits of competition in the particular case, proved losses of economies, however large, could be offset on the basis of an unexplained and unsupported statement that they are outweighed by the possible advantages of increased competition. This would give the Commission *carte blanche* arbitrarily to order divestment in any case it so desires, and as the court below noted, would make its judgment as a practical matter "unreviewable" (Pet. 32).

**(ii) The court correctly found that the Commission's rejection of the Ebasco severance study in its entirety was based on insufficient reasons and was contrary to conclusive evidence in the record.**

The Petition's second specific question is whether the court below properly held that the Commission erred in rejecting the Ebasco Report in its entirety (Pet. 3). The Petition assumes that the alleged deficiencies found in the Report by the Commission were "serious" (Pet. 3). The court below, however, found that they related at most to a relatively small part of the losses (Pet. 92), and were in any event an insufficient basis for total rejection, and held that the record showed conclusively that some losses were inevitable (Pet 24). This difference is precisely the kind of evidentiary question involving a careful review of the record and evaluation of administrative findings which this Court has traditionally entrusted to the courts of appeals. It is more fully discussed under item 4 at page 12 below.

### (iii) The court did not require the Commission to make a specific determination of the future rate of return.

The Petition's third specific question is based on the assumption that the Commission found "that the separated [gas] system would have an adequate margin of revenue over costs for successful independent operation", and suggests that the court improperly required the Commission to make "a specific determination as to the system's future rate of return" (Pet. 3, 10). The Commission did not make the assumed finding, and the court did not require the specified determination.

What in fact the court did was to require the Commission to address itself to a prediction of the effect of the estimated losses on the economic health of the particular companies involved in their particular circumstances (Pet. 30). It specifically disclaimed any intention to define any one test, but suggested that a proper analysis and application of the statutory standard to the evidence by the Commission *might* involve consideration of such relevant factors as the effect of the losses on new equity financing, the effect of reduction of rate of return on investment, the effect of the losses on the cost of borrowing money and, if rate increases seemed probable, whether the effect would be to "injure deeply, hurt slightly, or affect not at all the companies' ability to survive" (Pet. 30-31). As the court noted, "The Commission considered none of these." (Pet. 31).

## 4. The holding of the court below on the Ebasco Report was correct.

The Ebasco Report dealt with all facets of the NEES operation and projected in detail the estimated losses which would result from severance. The Ebasco personnel responsible for preparation of the Report were duly qualified

as experts and testified as witnesses on both direct and cross examination. The Chairman of the Massachusetts Department of Public Utilities as well as executive officers of NEES, all of whom concurred in the Report's conclusions, were also so qualified and so testified. At no time has the Commission or its staff even suggested that any of the expert witnesses involved was not qualified or that the sincerity or veracity of any was in any way in doubt. (See Pet. 50.) Indeed, as the court below pointed out, the Commission demonstrated its confidence in the Ebasco Report by accepting its cost estimates for other purposes in this same case (Pet. 24, 94).[9]

In support of its divestment order, the Commission found (as an alternative holding) that the credibility of that portion of the Ebasco Report which stated the estimated increases in treasury and accounting costs amounting to \$472,100 (approximately 40% of the total estimated annual losses), had been substantially impaired and could not be believed, and accordingly that the entire Report was to be rejected (Pet. 55). The Commission based this conclusion on (i) Ebasco's alleged failure to consider use of combined customer billing and (ii) alleged disparities in the allocation of certain accounting expenses of the gas and electric companies at Northampton and Lynn, Massachusetts (Pet. 52-55).

The first ground for rejection was apparently based on an obvious mistake of fact: Ebasco had carefully considered the use of combined billing and rejected it, as noted by the court below in its first review of the Commission's Findings and Opinion (Pet. 90-91). Furthermore, with respect to the first ground for rejection, the court below pointed out that customer billing constituted a small portion of customer accounting (in turn part of the \$472,100 total treasury and

[9] The court has incorporated in its second opinion its comments on the evidentiary questions stated in its first opinion (Pet. 24).

accounting figure), and that even if combined customer billing were used, as the Commission suggested, the saving would result, at most, in a partial reduction in the approximately $60,000 which the court estimated as the amount of the increased customer billing expense (Pet. 92). With respect to the second ground for rejection, the alleged disparity, the court below noted that the Commission had not contended that many sizeable items attributable to the disparity would be removed from the $472,100 cost estimate (Pet. 92). The court concluded that on the record even at minimum the losses from severance were "$1,098,000 minus some fraction of $472,000" (Pet. 94). It held in consequence that:

> ". . . these items [the Commission's criticisms as to combined billing and disparate treatment] constitute at most a basis for reducing the estimated figure by some amount, not for concluding that no increased costs have been proved. In fact, the record here demonstrates conclusively that *some* increased costs are inevitable — the only doubt possible concerns the amount." (Pet. 24).[10]

In the absence of conscious falsehood, the doctrine of "*falsus in uno, falsus in omnibus*" does not ordinarily apply, and an expert's report may ordinarily be impeached only if his alleged errors are directly related to the other aspects of his testimony or are of so substantial a nature as to indicate carelessness or otherwise cast doubt on his qualifications. See *Hoag* v. *Wright*, 174 N.Y. 36, 43, 66 N.E. 579, 581

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[10] The court continued by saying that the Commission should "attempt to determine some acceptable figure" and establish "its best estimate of the extent of the definable losses likely to result" in order to assess their impact on the economic health of the companies involved (Pet. 25, 30). Contrary to the Petition's suggestion (Pet. 10, 12), this holding does not impose on the Commission the kind of judgment it has in the past been unable or unwilling to make. For example, in Engineers Pub. Serv. Co., 12 S.E.C. 41, 60 (1942), the Commission, believing that the estimated increased expenses were overstated, determined the amount which it believed the record would sustain.

(1903); 3 WIGMORE, EVIDENCE §1013 (3d ed. 1940). Further, since the practicality of combined customer billing is a matter requiring expert specialized knowledge as to which an agency with the broad jurisdiction of the Commission cannot fairly be expected to have detailed expertise, the Commission may not disregard the testimony of an accepted expert in the absence of any countervailing evidence. See *Market St. Ry.* v. *Railroad Comm'n,* 324 U.S. 548, 560 (1945); *Cullers* v. *Commissioner,* 237 F.2d 611, 616 (8th Cir. 1956). There was no countervailing evidence here and the Commission has given no reasons beyond what it described as an inadequate explanation of Ebasco's not adopting other alternatives in billing and cost allocations (for which there was no support in the record) instead of those which the Commission considered proper (Pet. 53-55).

## CONCLUSION

The Petition for a writ of certiorari should be denied.

Respectfully submitted,

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July 28, 1967

No. 305



# In the Supreme Court of the United States

OCTOBER TERM, 1967

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SECURITIES AND EXCHANGE COMMISSION, PETITIONER

*v.*

NEW ENGLAND ELECTRIC SYSTEM, ET AL.

---

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT*

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## REPLY MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

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Respondents urge (p. 6) that only evidentiary and factual questions remain in this case and suggest (p. 7) that we are asking this Court to determine whether the court below correctly applied the standard that agency decisions must be supported by substantial evidence. On the contrary, the court below did not find that the Commission's decision was not supported by substantial evidence, and we are not asking this Court to review the evidence. We seek

review because the court below restricted the Commission's authority to limit public utility holding companies to a single integrated system in a manner which is contrary both to this Court's prior decision and to the purpose and policy of the Act. This was done in three principal ways.

1. The court transmuted this Court's requirement that holding companies seeking to retain additional systems must meet a "much more stringest test" than that originally applied by the court below into a rule that a Commission decision declining to permit a holding company to retain an additional system will be invalidated if it fails to withstand a "*most stringent* practical standard" of analysis and expertise (Pet. 22). Respondents explain (Br. in Opp. 9):

> The importance of the care and thoroughness required of the Commission by the court below is emphasized by this Court's standard of "serious impairment." The line is now drawn so close to the point of probable business failure that not only does it make the holding company's burden of proof a difficult one to carry, but it also makes the risk more substantial that a divestment order based on erroneous findings and broad assumptions rather than individual consideration will result in economic disaster (Pet. 27).

Thus, the Commission's reading of Clause A, which this Court upheld and found to have been consistently adhered to by the Commission (384 U.S. 176, 179, 182), is to result in all doubtful questions being resolved against the Commission. By this alchemy the holding company's "difficult" burden of proof becomes

an obstacle rather than an aid to carrying out Section 11.

2. The court below required the Commission to treat as proven holding company estimates of the amount of loss which would be entailed by separation of an additional system, however unconvincing such estimates may be, except to the extent that the Commission proves them to be fallacious. The Commission must then confine its inquiry to the possible impact of a loss of that amount upon various financial aspects of the particular system, since the court below rejected as irrelevant the size and operating characteristics of the system and comparisons with the actual operation of other systems.

The requirement that the Commission must accept estimates of loss contained in the Ebasco report, except insofar as the Commission could demonstrate particular errors of fact or analysis, not only ignores unexplained disparities in the estimates of increased expense,[1] but, more fundamentally, ignores the fact that the alleged losses represent only an aggregate of estimated items of cost of obtaining, on a separate basis for the severed gas system, those limited services for these unrelated businesses that are now per-

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[1] As indicated in its Findings and Opinion (Pet. 52-57), the Commission concluded that the Ebasco study was based on questionable assumptions and cost allocations which affected the reliability of a substantial part of the Ebasco estimate. There is no basis upon which it can be determined that, as a consequence of these defects, the projected increase in cost would be reduced only by $60,000, as calculated by the court below and emphasized by respondent (Br. in Opp. 14).

formed by service company employees or by common employees of the gas and electric company. It is inherently doubtful that estimates so constructed and submitted on behalf of the holding company seeking to retain both its electric and gas properties would represent the actual difference between (a) the results of operations as part of a holding company system operating both electric and gas properties and (b) the results of actual operation of a severed system under a management operating only gas properties and with normal motives for achieving maximum profits.[2]

3. The court below refused to permit the Commission to give weight in a particular case to the advan-

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[2] *Market Street R. Co.* v. *Railroad Commission*, 324 U.S. 548, upon which respondents rely (p. 15), does not aid them. There in rejecting the contention that an order of a State public utility commission reducing rates was invalid because not based on expert testimony as to the effect of the reduction on the volume of traffic, the Court stated (p. 560): "Experts' judgments, however, would not bind the Commission. Their testimony would be in the nature of argument or opinion, and the weight to be given it would depend upon the Commission's estimate of the reasonableness of their conclusions and the force of their reasoning." Respondents suggest that the Securities and Exchange Commission "cannot fairly be expected to have detailed expertise" as to such matters as "the practicability of combined customer billing," and that the agency therefore was required to accept the estimates on these issues contained in the Ebasco report. But the Commission's broad experience and expertise in the administration of the Public Utility Holding Company Act of 1935 qualified it to evaluate the overall reliability of the Ebasco study—a study which, by its very nature, basically involves "argument or opinion."

tages of free competition and independent operation except to the possible extent that some "definable particularized benefit will accrue" (Pet. 33), notwithstanding this Court's conclusions in its prior opinion that the benefits of competition, although "difficult to forecast," are a matter for Commission expertise on the total competitive situation. 384 U.S. at 184.

Respondents argue (pp. 10-11) that the court below has not required the Commission to make a finding of "specific dollar value" but merely a "best estimate" or a finding or articulation of "specific or approximate financial benefit" before it can give weight in the particular case to benefits likely to flow from competition. This scarcely meets the issue whether the decision below conforms to this Court's opinion, which we view as upholding the propriety of the Commission giving weight to "[c]ompetitive advantages to be gained by a separation" however "difficult to forecast." That conclusion, contrary to the suggestion of the court below, does not make the Commission's divestment orders as a practical matter "unreviewable." It merely means, as this Court suggested, that the extent of the gains to competition and the related public interest are matters with respect to which the Commission is entitled to use its expertise and that the Commission is not limited to a "prediction whether, for example, a gas company in a holding company system may make more for investors than a gas com-

pany converted into an independent regime." 384 U.S. at 185.

Respectfully submitted.

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No. 305

# In the Supreme Court of the United States

OCTOBER TERM, 1967

SECURITIES AND EXCHANGE COMMISSION, PETITIONER
*v.*
NEW ENGLAND ELECTRIC SYSTEM, ET AL.

*ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT*

## BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

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## CITATIONS

# In the Supreme Court of the United States

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## BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

### OPINIONS BELOW

The opinion of the court of appeals (A. 48–65) is reported at 376 F. 2d 107.[1] The findings and opinion of the Securities and Exchange Commission (A. 3–28) are reported at 41 S.E.C. 888. An earlier opinion of the court of appeals (A. 29–47) is reported at 346 F. 2d 399. This Court's opinion reversing the court of appeal's first decision is reported at 384 U.S. 176.

### JURISDICTION

The judgment of the court of appeals was entered on March 31, 1967 (A. 66). The petition for a writ

[1] The appendix to the briefs is cited as "A.", and the certified record in *Securities and Exchange Commission* v. *New England Electric System, et al.*, No. 636, October Term, 1965, is cited as "R.".

of certiorari was filed on June 28, 1967 and was granted on October 9, 1967 (389 U.S. 816). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

## QUESTIONS PRESENTED

Section 11(b)(1)(A) of the Public Utility Holding Company Act of 1935, 15 U.S.C. 79k(b)(1)(A), permits a public utility holding company to control more than one integrated public utility system only if separation would entail "the loss of substantial economies." In *Securities and Exchange Commission* v. *New England Electric System,* 384 U.S. 176, this Court (reversing the court of appeals, which had set aside the Commission's order) held that the statute is not satisfied by showing that separation will result in a substantial business loss; the economies from retention must be so important that their loss would cause a serious impairment of the separated system. On remand the court of appeals again set aside the Commission's order. The basic question presented is whether, in so doing, the court misapprehended the standard laid down by this Court for interpreting the substantial-economies provision and improperly shifted the burden of proof on the issue of substantial economies from the holding company to the Commission. In addition, we present these specific questions which are facets of the lower court's basic error:

1. Whether the Commission, having found that respondent's study of the added costs of independent operation contained serious deficiencies, was entitled to reject the study in its entirety as providing an unreliable basis for determining whether divestiture of

the gas properties would cause a loss of substantial economies.

2. Whether the Commission, having found on the basis of evidence concerning comparable utility systems that the separated system would have an adequate margin of revenue over costs for successful independent operation, was also required to make a specific determination as to the system's future rate of return and its effect upon the cost and availability of financing.

3. Whether the Commission, in deciding whether a loss of substantial economies would occur, was entitled to consider offsetting advantages that the separated system would likely enjoy by reason of independent operation, without attempting to fix a specific dollar value therefor.

## STATUTE INVOLVED

Section 11(b) of the Public Utility Holding Company Act of 1935, 49 Stat. 820, 15 U.S.C. 79k(b), provides in pertinent part:

> It shall be the duty of the Commission, as soon as practicable after January 1, 1938:
>
> (1) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such action as the Commission shall find necessary to limit the operations of the holding-company system of which such company is a part to a single integrated public-utility system, * * *: *Provided, however,* That the Commission shall permit a registered holding company to continue to control one or more additional integrated public-utility systems, if,

after notice and opportunity for hearing, it finds that—

(A) Each of such additional systems cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system * * *.

STATEMENT

Respondent New England Electric System ("NEES") is a holding company registered under Section 5 of the Public Utility Holding Company Act of 1935, 49 Stat. 812, 15 U.S.C. 79e. It controls electric utility companies serving customers in New Hampshire, Massachusetts, Rhode Island and Connecticut and retail gas companies in Massachusetts. In 1957 the Securities and Exchange Commission, pursuant to Section 11(b)(1) of the Act, instituted proceedings to determine (among other questions) whether NEES was entitled to retain the gas companies. Section 11(b)(1) provides that a registered holding company, unless it qualifies for an exception under the statute, may control only a single integrated public utility system. NEES' electric properties have been found to constitute such a system (*New England Electric System*, 38 S.E.C. 193), and NEES has elected to retain them in the event that it cannot also control the gas companies. NEES argued that it was entitled to retain the gas system under the exception provided by Clause (A) of Section 11(b)(1), which permits retention of an additional system that "cannot be operated as an independent system without the loss of substantial economies." After extended

hearings, the Commission rejected this contention and ordered the divestiture of the gas companies, 41 S.E.C. 888; A. 3–28.

When that portion of the proceeding before the Commission dealing with the question of whether NEES could retain its gas companies began, NEES controlled, *inter alia,* seven electric utility companies, eight gas utility companies and a service company. The retail electric companies served 824,000 customers in a franchise area of 4,600 square miles within the States of New Hampshire, Massachusetts, Rhode Island and Connecticut (A. 4). The gross investment in electric plant and equipment, as of December 31, 1958 (the last year for which audited figures were presented), was approximately $600,000,000, and gross revenues from sales of electricity in 1958 were approximately $143,000,000 (A. 4).

NEES's gas subsidiaries provided retail service to 237,000 customers in a franchise area of 660 square miles entirely within Massachusetts. Seventy-five percent of this area was also a part of the franchise area of NEES's electric subsidiaries, and about 78 percent of the gas customers were also served by NEES's electric subsidiaries. As of December 31, 1958, NEES's gross investment in gas plant and equipment was approximately $56,300,000 and gross revenues in 1958 from the sale of gas were $22,700,000 (A. 4–5). Except for manufactured gas used only during peak periods and for emergency standby purposes, NEES sells natural gas obtained by pipeline from the southern United States (A. 5). Of the twelve Massachusetts nonaffiliated gas companies which respondents

selected during the proceedings for comparison with NEES, only one exceeded the NEES gas utility system in size of gross plant, gross annual revenues or number of customers (A. 18, n. 24; R. 1365).

NEES acquired most of its gas subsidiaries between 1926 and 1931. In 1951, "as a step in effectuating compliance by NEES with the integration provisions of Section 11(b)(1) of the Act," NEES proposed to sell its Massachusetts gas properties as a unit and obtained three bids therefor (A. 5, 10 n. 13; R. 48, 70).[2] Although NEES signed a contract for such sale, it was not consummated because the purchaser failed to obtain the anticipated financing (A. 5; R. 48, 70).

Thereafter, NEES abandoned attempts to sell in favor of a long range plan to "develop and promote the natural gas business" (R. 71). William Webster, president of NEES, testified in explanation of this change of policy, that by 1948 its electric business was experiencing a post-war growth, but "we had come to realize that the manufactured gas business had a rather dim future * * *" (R. 68). He said that from 1948 to 1951 NEES was increasingly concerned with difficulties of raising equity capital and since the gas properties were then "contributing little if anything to [NEES's] net earnings," a sale thereof "seemed clearly indicated from an economic standpoint" (R. 69). After the 1952 proposed disposition failed, however, NEES realized that with the advent of natural gas, "gas had a fair chance in the market and could be built up to pull its own weight as a part of the System" (R. 71). The effort to promote and

[2] *New England Electric System*, S.E.C. Holding Company Act Release No. 11016 (1952).

develop NEES's natural gas distribution business "produced results beyond * * * early hopes," with gross operating revenues increasing about 83 percent from 1951 to 1959 and consolidated income from the gas properties rising from $250,000 to $2,100,000 in the same period (R. 73).

The eight gas companies are organized administratively as a gas division with centralized management, marketing and supply, operations, and merchandising departments (A. 5). All of the companies are located within 48 miles of the division headquarters, except one company which is 80 miles away (A. 5 n. 5). The head of the Gas Division is also the president of each gas company and is ultimately responsible to NEES's vice-president in charge of management (A. 5; R. 1305).

In rejecting NEES's contention that the gas system was retainable as an additional system which "cannot be operated as an independent system without the loss of substantial economies * * *" within the exception of Clause (A) of Section 11(b)(1), the Commission found that NEES's estimate of the loss of economies flowing from divestiture was exaggerated (A. 9–14) and that, even accepting *arguendo* NEES's figure, NEES had failed to show a "loss of substantial economies" within the meaning of Clause (A) (A. 16). In so holding, the Commission interpreted the relevant provision, as it had in prior divestment cases dating back more than twenty years, to require a showing that each "additional system cannot be operated under separate ownership without the loss of economies so important as to cause a serious impairment of that

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system" (A. 9). Under this test, the Commission ruled, it was unable "to find that the gas companies could not be soundly and economically operated independently of NEES" (A. 25).

In its initial review, the court below set aside the Commission's order on the ground that the Commission had misinterpreted the statutory standard of "loss of substantial economies" (A. 29–47). In that court's view, Clause (A) merely "called for a business judgment of what would be a significant loss" (A. 39). This Court reversed. 384 U.S. 176. It approved the Commission's interpretation, and remanded the case to the court of appeals for "review of the challenged order in light of the proper meaning of the statutory term." 384 U.S. at 179–180.

On remand, the court below again set aside the Commission's order. Proceeding on the premise that the Commission is to be held to a *"most stringent"* standard in evaluating a claim of loss of substantial economies (A. 52), the court identified three areas where, in its view, the Commission's analysis had been deficient.

1. In the proceedings before the Commission NEES had introduced and relied on a cost study, prepared by Ebasco Services, Inc. ("Ebasco"), which purported to show that the gas system would incur some $1 million annually in additional costs of billing, meter reading, accounting and other items if separated from the electric system. The Commission had found that the study was deficient in a number of particulars and generally failed to provide a reliable basis for measuring the costs of independent operation,

especially in view of its inconsistency with the experience of comparable independent gas systems (see *infra*, pp. 21–25, 27–31). The court of appeals, while observing that "[w]e do not necessarily criticize the Commission for its skepticism in the specifics," nevertheless held that the Commission had erred in rejecting the study as a basis for decision and that the Commission should have reduced the Ebasco estimate by some determinate amount and then considered whether the corrected estimate was substantial (A. 54).

2. NEES had argued to the Commission that since gas companies in New England operate on a small margin of revenue over costs—this because of the high cost of gas in that region—its gas system could not afford such added costs as might be entailed by independent operation. The Commission had rejected this contention, noting, among other things, that other gas systems in Massachusetts operate profitably, including those not under common control with electric systems; that the gas system resulting from separation would be the second largest in the region; and that its ratio of costs to revenue—even assuming that the estimate of additional expenses contained in the Ebasco study were correct—would compare favorably with other Massachusetts gas systems. The court of appeals found the Commission's answer inadequate. It held that "the focus must be on the specific characteristics of the NEES companies"—in particular, on whether the rate of return that that gas system would enjoy after separation would be large enough to attract the new investment necessary for the survival and growth of the system (A. 56–59).

3. In finding that NEES's gas system could effectively stand alone, the Commission had relied in part on a presumption drawn from the history and purpose of the Public Utility Holding Company Act and from its own experience that a gas system is more likely to prosper if it is free from the control of a holding company that has interests in a competing business. The court of appeals held that the Commission could not give "independent significance to the generalized competitive advantages" that it had found but must "confine itself to a quantitative analysis of the substantiality of" economies lost (A. 61).

The court remanded the case to the Commission "for further proceedings and an analysis by the Commission responsive to the difficulties which we have set forth" (A. 61).

## SUMMARY OF ARGUMENT

Under Section 11(b)(1) of the Public Utility Holding Company Act, the Securities and Exchange Commission is directed by Congress to require each holding company system to limit its operations to "a single integrated public-utility system." As an exception to that general command, the Commission is to permit the retention of control over one or more additional integrated systems if it finds, under Clause A of Section 11(b)(1), that each such additional system "cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system." NEES has both an electric and a gas system, and has elected to retain its electric system. The question here is whether the Commission properly con-

cluded that NEES could not also retain the gas system, because it had failed to show that the gas system cannot be separately operated without the loss of economies "so important as to cause a serious impairment of that system" (A. 9)—the interpretation which the Commission consistently had given to the "loss-of-substantial economies" standard in Clause (A) and which this Court upheld when the case previously was here. 384 U.S. 176.

The determination whether divestiture of an additional system will entail the loss of substantial economies requires the exercise of an informed judgment as to the significance of a number of intangible factors, most of which necessarily are not susceptible to precise dollar evaluation. That determination has been confided by Congress to the Commission, and the agency's conclusion is to be accepted upon review "if it has 'warrant in the record' and a reasonable basis in law" (*National Labor Relations Board* v. *Hearst Publications,* 322 U.S. 111, 131). The Commission's ruling that NEES had not sustained its burden of showing that divestiture of its gas system would entail the loss of substantial economies meets both of those requirements, and the court of appeals should have upheld the divestiture order.

A. NEES relied upon the Ebasco study to show the additional costs that allegedly would result from divestiture. The Commission found that the study had serious deficiencies that rendered it inadequate as a basis for any reliable prediction of such increases. The court of appeals held that the Commission

had improperly rejected the study, on the ground that the deficiencies would only justify the agency in reducing the estimates by some specific amount, but not in rejecting the study completely. But since the holding company has the burden of proving that it is entitled to the exemption that Clause (A) provides from the general prohibition upon retention of more than one system, the Commission is justified in denying an exemption if the company's proof is inadequate; the agency is not itself required to remedy such defects.

The determination whether divestiture will entail a loss of substantial economies calls for analysis of factors that are not susceptible to precise measurement and involves predictions that are necessarily speculative. The Ebasco study, for all its seeming mathematical exactitude, was no more than an attempt to assign dollar consequences to a multitude of business decisions that might—or might not—follow divestiture of the gas system and necessarily reflected a large number of judgment factors. It did not have the certainty that the dollar estimates it contains seem to suggest. In the circumstances, the serious deficiencies in the study found by the Commission justified the agency in rejecting it.

B. On the supposition that NEES presents a unique situation, the court of appeals dismissed the Commission's extensive documented experience with other utility systems, observing that "[c]omparison with figures derived from the situations of other companies in other places at other times cannot be conclusive" (A. 58). Thus the court rejected as immate-

rial the Commission's determination that, even accepting, *arguendo,* the loss of economies predicted by NEES' cost study, the ratios of such loss to revenues, revenue deductions, gross and net income were "lower or not significantly higher than corresponding ratios of gas systems whose divestment we have required on the ground that the estimated loss of economies was not substantial within the meaning of Clause A" (A. 16, 28). Again, the Commission noted that 12 other gas companies in Massachusetts, all but one of which were smaller than the NEES gas system, were able to compete successfully with oil, that the NEES gas system was larger than systems ordered divested in prior cases, and that "several of those systems in turn were larger than companies that had demonstrated conclusively their ability to operate effectively free of holding company control" (A. 18 n. 24). Particularly in light of the necessarily conjectural nature of the forecasts involved, the Commission was properly guided by its knowledge of other public utility systems and its experience with successfully accomplished divestitures in determining that the divestiture of the NEES gas system would not entail a loss of economies so substantial as to cause a serious impairment of the system. Moreover, the legislative history of the Act reflects a congressional recognition that ordinarily only small additional systems would be retainable; NEES is not a small system.

C. In concluding that divestiture would not entail a loss of substantial economies, the Commission took into account the likelihood that the NEES gas system, if freed from control of a holding company that

has a major financial stake in a competing energy source, would realize competitive advantages tending to offset any increased expenses. As this Court noted when the First Circuit's prior decision in this case was before it (384 U.S. 176, 183): "One of the evils that had resulted from control of utilities by holding companies was the retention in one system of both gas and electric properties and the favoring of one of these competing forms of energy over the other." In its present decision, however, the court of appeals held that the competitive advantages of independence were relevant only in interpreting the statutory standard but have no "independent significance" in applying that standard in a particular case. Although the "[c]ompetitive advantages to be gained by a separation are difficult to forecast," they are nonetheless "a matter for Commission *expertise*" (384 U.S. at 184–185), and the Commission was fully justified in taking them into account here.

## ARGUMENT

### THE COMMISSION PROPERLY RULED THAT NEES HAD FAILED TO ESTABLISH THAT THE DIVESTITURE OF ITS GAS SYSTEM WOULD ENTAIL THE LOSS OF SUBSTANTIAL ECONOMIES WITHIN THE MEANING OF SECTION 11(b) (1) (A) OF THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

Section 11(b)(1) of the Public Utility Holding Company Act of 1935 (15 U.S.C. 79k(b)) directs the Commission to require every registered holding company to limit its operations to "a single integrated public-utility system." Clause (A) of that Section, however, permits a holding company to retain an ad-

ditional integrated system that the Commission finds "cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of [holding company] control * * * ." Since NEES has elected to retain its electric utility system, the question here is whether the Commission properly ordered divestiture of the gas system because NEES had not established that such divestiture would entail the "loss of substantial economies." In so holding, the Commission applied its settled interpretation that substantial economies were those "so important" that their loss would "cause serious impairment of that [additional] system" (App. 9), and it concluded that the record did not show that "the gas companies could not be soundly and economically operated independently of NEES * * *" (App. 25).

The court below originally held that the Commission's interpretation of Clause (A) was unduly narrow; it construed the Act as requiring only "a business judgment of what would be a significant loss" (A. 39). When this case was here before, however, this Court held that the Commission's interpretation was "well within the permissible range given to those who are charged with the task of giving an intricate statutory scheme practical sense and application" (384 U.S. at 185). The Court also pointed out (*id.* at 180; footnotes omitted):

> The requirement in § 11 of a "single integrated" system is the "very heart" of the Act. The retention of an "additional" integrated system is decidedly the exception. * * *

Since Clause (A) is an exception to the general statutory prohibition upon retention of more than a single system, the burden is upon the company to show that it comes within the exception. See *United States* v. *First City National Bank of Houston,* 386 U.S. 361, 366. Hence, it is inappropriate to resolve doubts as to the evidence so as to favor the retention of an additional system, or to require the Commission to fill gaps in the company's proof.

The determination whether divestiture of an additional system will entail the loss of economies that are "substantial" in the sense of posing the threat of a "serious impairment" of the system calls for the exercise of an informed and delicate judgment as to the significance of a number of intangible factors, most of which necessarily are not susceptible to precise dollar evaluation. Indeed, even the dollar amount of the additional expenses likely to be incurred upon divestiture cannot be foretold with anything approaching mathematical exactitude, since it, too, involves many intangible considerations (see Point A, *infra,* pp. 18–21). In addition, other factors which cannot be measured with precision must be taken into account before a final evaluation can be made whether ~~the claimed~~ there will be a loss of economies of the significance that Congress intended to treat as "substantial" under Clause (A). These factors include the advantages that are likely to be realized when the gas system is freed from common control with the electric system and is immunized from the possible "favoring of one of these competing forms of energy over the other" (384 U.S. at 183); and the congressional recognition reflected in the legislative

history of the Act that ordinarily large additional systems can be economically operated on an independent basis and are therefore unlikely to be seriously impaired by divestiture (see *infra*, pp. 31–33).

Thus, the nature of the judgment the Commission is required to make in deciding whether an estimated loss of economies resulting from divestiture is "substantial" within the meaning of Clause (A) necessarily involves the application of the skill and experience the agency has acquired in its many years of administering the Public Utility Holding Company Act. Indeed, this Court explicitly recognized, when the case was here before, that the evaluation of the "[c]ompetitive advantages to be gained by a separation [of gas and electric systems] * * * is a matter for Commission *expertise* on the total competitive situation * * *" (384 U.S. at 184–185). No less "a matter for Commission *expertise*" is the making of the ultimate judgment whether, in all the circumstances, the particular projected loss of economies will be "substantial," and judicial review of that determination necessarily is limited. The Commission's determination that an alleged loss of economies would not be substantial—like an agency's "application of a broad statutory term" to a particular factual situation—"is to be accepted if it has 'warrant in the record' and a reasonable basis in law" (*National Labor Relations Board* v. *Hearst Publications,* 322 U.S. 111, 131; see, also, *Gray* v. *Powell,* 314 U.S. 402, 411–412; *Atlantic Refining Company* v. *Federal Trade Commission,* 381 U.S. 357, 367–368). The Commission's ruling that NEES had not shown that divesti-

ture of its gas system would entail the "loss of substantial economies" meets both of those requirements, and the court of appeals should have upheld the divestiture order.

A. THE COMMISSION WAS JUSTIFIED IN REJECTING THE ESTIMATE IN THE EBASCO STUDY OF THE ADDITIONAL EXPENSES THE GAS SYSTEM WOULD INCUR UPON DIVESTITURE, AND WAS NOT REQUIRED ITSELF TO SUPPLY A MORE ACCURATE ESTIMATE

The court below held that the Commission could not reject the Ebasco estimates of loss without making substitute forecasts of its own. It stated: "We do not necessarily criticize the Commission for its skepticism in the specifics; but we do think that even taken together these items constitute at most a basis for reducing the estimated figure by some amount, not for concluding that no increased costs have been proved. In fact, the record here demonstrates conclusively that *some* increased costs are inevitable—the only doubt possible concerns the amount." (A. 54)

Since the basic policy of the Act is against the retention of additional systems and the burden of establishing an exception is upon the holding company, even conclusive proof of some increased costs does not begin to meet that burden. As the Commission observed, "Congress was aware that some loss of economies would usually result from the separation of jointly controlled utility systems" (A. 8). The critical question before the court of appeals on this aspect of the case was whether the deficiencies in the Ebasco study justified the Commission in rejecting it as a basis for any reliable estimate as to the amount of ad-

ditional expenses likely to be incurred upon divestiture. We submit that the Commission was fully warranted in rejecting the study.

1. In our view the attribution of certainty to forecasts of losses of economies that might be caused by separation is illusory. We recognize that there are areas where economies of scale are indeed subject to relatively precise estimates by experts in the utility business. For example, construction and operation costs of generating units—whether using fossil fuel or atomic energy—may be projected with sufficient certainty clearly to demonstrate the cost advantages of relatively large rather than smaller units. Again, analysis of differing peaks of demand in different distribution areas which can be served by inter-connected facilities may point to clearly demonstrable savings from coordinated operations.[3]

But in measuring economies of scale attributed to common management of unrelated operating properties, no comparable certainty is possible. Here the estimate necessarily involves a complex analysis with numerous opportunities for errors of judgment at every step. The first step is to ascertain the cost of operating under the existing combined management. The Ebasco study assumed as a starting point the op-

[3] Savings of this character are not only readily demonstrable but are consistent with the economic philosophy of the Act, in view of the primary statutory objective of limiting each holding company to a single integrated system. As this Court noted: "Promotion of 'economy of management and operation' and 'the integration and coördination of *related* operating properties' * * * is a theme that runs throughout the Act" (384 U.S. at 182–183).

erating expenses of the gas system per books—but these book operating expenses reflected numerous allocations by the NEES management of joint costs as between electric and gas companies. "Allocation of costs is not a matter for the slide rule. It involves judgment on a myriad of facts. It has no claim to an exact science. Hamilton, Cost as a Standard for Price, 4 Law & Cont. Prob. 321."[4] *Colorado Interstate Gas Co. v. Federal Power Commission,* 324 U.S. 581, 589.

A second step in forecasting the consequences of severance is to predict what steps, at what cost and at what advantage, the future management may take after severance. Among the questions posed are: What new personnel will be hired at what salaries? Where separation results in a new individual performing only part of the function of a predecessor engaged in the former combined operations, will the new individual have surplus time and energies to devote to other purposes? If so, what advantages will accrue to the separated operation? Where the combined operation has shared office space, equipment, accounting or other facilities or services, can continued sharing be arranged on a contractual basis between the managers of the separated businesses? If not, can comparable joint arrangements be negotiated with other parties? Finally, what advantages may accrue from decision-making by a management freed from the influence presented by a large stake in a competing business?

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[4] As Hamilton aptly observes, "No accountant has been able to devise a method yielding by-product or point-cost figures which does not embody a dominance of arbitrariness and guesswork." See 4 Law & Cont. Prob. 321, 328.

The Ebasco severance cost study attempted to give in elaborate detail dollar-cost answers to such questions, including projected positions and salaries for future employees of the severed gas utility properties. Essentially, the study represented nothing more than the projected results of a multitude of separate assumptions as to business decisions which might or might not be arrived at after severance, although the reduction of these projections to precise figures suggests greater certitude. In fact, there may be a wide disparity between such a hypothetical aggregate and the actual results of decisions by those who would have the responsibility for operating the business as profitably as possible.[5] Thus, even a study of this type that had no specific deficiencies would be subject to the basic infirmity that, because it consists of an aggregate of interrelated value judgments on many factors, tangible and intangible, it necessarily does not have the certainty that the precise dollar estimates of additional costs seem to suggest.

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[5] Forecasts of loss of economies on severance are the counterpart of expected economies from combinations, an area in which business estimates have proved notoriously unreliable. This was recognized in an authoritative treatise when the Act was passed. See Dewing, *Financial Policy of Corporations* (3d ed. 1934) 740–775, comparing results and expectations for the industrial combinations in the period from 1897 through the early 1900's. For current illustration, see Biggs, "Day of Reckoning—Conglomerates Can't Keep Making Two Plus Two Equal Five Forever," *Barron's*, April 3, 1967, p. 3:

> According to a recent study * * * of acquisitions made between 1960 and 1965, in retrospect 36% were admitted to be mistakes. The key word is "admitted", since the interviewers detected a defensive reticence in certain other cases.

2. The Commission did not question the general relevance of the Ebasco study, but did find serious deficiencies which undermined its reliability. The study was originally prepared as a study of the aggregate of the loss of economies to each gas company if each should be required to operate independently. In a supplemental report Ebasco had attempted to readjust its study to allow for the hypothesis that the gas system would be divested as a unit, which was all that the Commission required. Ebasco concluded that the savings from operating the eight gas companies as a unit rather than separately would be not more than approximately $400,000,[6] leaving approximately $1,100,000 of its original $1,500,000 estimate as the loss of economies attributable to requiring the gas division to be separated from the electric companies.[7] This two step approach gave further op-

[6] The figure in the text is that used in the second opinion of the court below and reflects a $67,000 adjustment for increased charges from the service company as permitted after the Ebasco estimate had been prepared. The Commission's opinion and the first opinion of the court below both refer to the lower figure in the actual Ebasco estimate without this adjustment (A. 10 n. 13, 38 n. 8).

[7] If one accepts the relevance of small size as a criterion of retainability under Clause (A) (see *infra*, pp. 30–33), it may seem somewhat incongruous that more than 70 percent of the $1,500,000 aggregate was attributed to the claimed disadvantaged of requiring a $56,000,000 (gross asset) gas business to stand on its own feet and only about 30 percent to further break-up of the gas system into eight separate smaller units. A partial explanation of the paradox stems from the fact that respondent's claim to satisfy the requirement of Clause (A) rests primarily on the supposed advantages of combined operation of gas and electric operations serving the same areas, however substantial each of the operations may be.

portunity for exercise of judgment: first, in estimating the consequences of fragmentation into eight separate gas companies and then in revising that estimate for possible savings on the alternative hypothesis that the present combined operations of the gas companies will continue after severance.

The Commission noted that the changed basis of the study—from assumed fragmentation of the gas system to assumed divestment as a unit—did not result in any change at all in the $415,600 estimate of increase of customer accounting costs (A. 12). Specifically, NEES urged that there could be no advantages from combined billing over the estimated cost of separate billing by each of the eight companies of the 237,000 customers in a compact area. The Commission disagreed (A. 13), pointing out that "respondents have not given any satisfactory reason why at least some form or forms of combined billing procedure could not be employed advantageously by the gas companies, in light of the fact that their aggregate of 237,000 customers is located in a relatively compact area." In addition the Commission found "inadequately explained and casting doubt on the estimates * * * the disparity between the increases attributed to the gas companies and those attributed to the electric companies" (A. 13–14). For example, in the case of the gas and electric companies serving Northampton, of the total cost of jointly performed customer's accounting, $17,000 or $2.12 per customer had been allocated to the gas company and $34,200 or $3.60 per customer had been allocated to the electric company; the projected post-severance cost for the gas company alone

would allegedly increase 184 percent to $6.03 per customer, or a total of $48,400, whereas that of the electric company would allegedly increase only 13 percent to $4.05 per customer. The Commission pointed out that there were similar discrepancies as to projected changes in total treasury and accounting payroll costs of the two Northampton companies and also with respect to the customer's accounting and payroll costs respectively of the two companies serving Lynn. The Commission noted: "These areas of expense, in general, are related to the number of customers served and not the type of utility business conducted" (A. 14).[8]

The Commission further pointed out, as summarized in the opinion below, that "the estimated additional salaries and/or positions for the top executive staff of the gas system were also suspect" (A. 53–54). As to the losses claimed to be attributable from termination of affiliation with the NEES service company, the Commission referred to its prior decisions rejecting similar claims, noting (A. 15 n. 20) that it had previously stated that:

> "to accept an estimate of present benefit from services rendered by system service companies as a measure of economies which would be lost as a result of independence requires us to assume that financial severance will cast operating units completely adrift, incapable of pro-

[8] It was not necessary for the Commission to determine whether this disparity flowed from an existing unfair allocation of costs as between electric operations and gas operations or merely from an exaggerated estimate for the future. "Losses" attributable to either cause will not actually be incurred and obviously are not pertinent to the requirements of Clause (A).

viding themselves with comparable benefits as cheaply either directly or through mutual arrangements with other operating units. We cannot make that assumption."

Having failed to submit a study that provided a satisfactory basis upon which the Commission could predicate a finding that the economies to be lost upon divestiture would be so important as to cause serious impairment of the gas system, NEES did not sustain its burden of showing that the additional system was retainable.[9]

3. In a portion of its first opinion (A. 42), reasserted in the second (A. 54), the court below had stated:

> We have serious doubts as to the extent that the Commission is entitled to disregard an opinion on a matter obviously requiring expert, specialized knowledge with no further evidence before it than what had been considered by the accepted expert. * * * This is not a matter on which a body having such broad jurisdiction

[9] The court below held that the Commission erred in imposing too heavy a standard of proof upon respondent (A. 54 n. 3). This criticism relates to the Commission's statement "that a registrant seeking to retain an additional system has the burden of showing by clear and convincing evidence that such additional system cannot be operated under separate ownership without the loss of economies so important as to cause a serious impairment of that system" (footnote citations omitted) (A. 9). Whatever the general significance of the distinction between "clear and convincing evidence" and "a fair preponderance of the evidence" in resolving factual disputes on the basis of conflicting testimony, we believe the distinction has no relevance to a respondent's burden under Clause (A), where the issue is primarily as to matters of opinion and as to whether, upon otherwise undisputed facts, a case has been made out for exception from the primary policy of the Act.

> as the Commission can have detailed expertise upon which to base affirmative findings. Compare *Market St. Ry. v. Railroad Commission,* 324 U.S. 548, 560. * * *

*Market Street Railway,* which the court below apparently considered distinguishable, supports the power of the Commission to reject, even in the absence of conflicting testimony, such estimates as were contained in the Ebasco report. There, in rejecting the contention that an order of a State public utility commission reducing rates was invalid because not based on expert testimony as to the effect of the reduction on the volume of traffic, the Court stated, 324 U.S. at 560: "Experts' judgments, however, would not bind the Commission. Their testimony would be in the nature of argument or opinion, and the weight to be given it would depend upon the Commission's estimate of the reasonableness of their conclusions and the force of their reasoning."

Respondents urge (Br. in Opp., p. 15) that the Commission "cannot fairly be expected to have detailed expertise" as to such matters as "the practicability of combined customer billing," and that the agency, therefore, was required to accept the estimates on these issues contained in the Ebasco report. But the Commission's broad experience in the administration of the Holding Company Act qualified it to evaluate the overall reliability of the Ebasco study—a study which by its very nature involves "argument or opinion." If the Act is to accomplish its purpose, the Commission should neither be required to remedy the deficiencies in the holding company's proof, nor be limited in its power to reject estimates which it finds

unconvincing and which rest upon as many imponderables as those presented by NEES, merely because cast in the form of expert testimony.

B. THE COMMISSION WAS JUSTIFIED IN CONCLUDING THAT, EVEN ACCEPTING *ARGUENDO* THE EBASCO ESTIMATE OF INCREASED EXPENSES UPON DIVESTITURE, SUCH INCREASE WOULD NOT CONSTITUTE THE LOSS OF SUBSTANTIAL ECONOMIES

1. The assumption by the court below that experts in the business can forecast with accuracy losses from severance of an additional system is, we believe, at the root of that court's rejection of the Commission's comparative evaluation of the claimed loss of economies. After detailing its reasons for rejecting the Ebasco forecasts, the Commission stated (A. 16):

> Even were we to accept the $1,098,600 estimate of loss of economies to the NEES gas companies, it would not lead us to conclude that such a loss is so substantial, when compared with the loss of economies involved in prior divestment cases and viewed in light of the objectives of the Act, as to warrant retention of the gas properties under common control with the NEES electric system. * * *

Thus the Commission, accepting *arguendo* the Ebasco cost estimates, proceeded to show that other utilities had prospered under like circumstances, and that there was no evident reason why the NEES gas system should not do as well. The court dismissed the Commission's analysis with the observation that "[c]omparison with figures derived from the situations of other companies in other places at other times cannot be conclusive" (A. 58). We believe, on the contrary, that given the highly conjectural nature of the predic-

tions involved, the Commission must be guided by its knowledge of other public utility systems and its experience with successfully accomplished divestitures—that is to say, by the very stuff of its expertise.

The Commission used the Ebasco figure for comparative purposes in applying the statutory test of substantiality, computing the percentage relationship thereof to operating revenues, expenses and income, as it had consistently done in prior decisions under Clause (A). The Commission noted that the claimed loss of economies amounted to 4.83 percent of operating revenues, 6.03 percent of operating expenses and 29.94 percent of net income before taxes (A. 16). The court below apparently considered as significant only the ratio of the forecast losses to net income—as the measure of the assumed loss to investors (see A. 57–58). But the wide disparity between the ratio of the claimed loss of economies to net income and the much lower ratios to operating revenues and expenses are indicative of how misleading it is to give conclusive weight to such a forecast in the light of the other factors which the Commission noted in reaching its overall conclusion.

This may be illustrated by reference to a schedule of consolidated income for the gas companies for the year ended December 31, 1960 (Respondent's Exhibit No. 87A, R. 1352). The schedule shows consolidated total operating revenue of $27,221,026 for the gas subsidiaries. The Ebasco forecast rested on the assumption that severance would result in no improvement in operating revenues. If, contrary to this assumption, the increased expenditures from employing the addi-

tional personnel assumed by Ebasco, or the more vigorous competition with the electric companies which severance would permit, should result in an increase of operating revenue by only two percent of the 1960 figure, or $544,000, that would offset approximately half of the estimated loss. The 1960 figure for consolidated operating expenses, excluding taxes, amounted to $20,230,333. Ebasco forecast in effect that this would be increased by $1,098,600 to $21,300,000. If the actual expenses were only three percent (or $639,000) less than this total figure, this also would wipe out more than half of the estimated loss.[10]

After summarizing the pertinent ratios, the Commission stated: "These ratios are lower or not significantly higher than corresponding ratios of gas systems whose divestment we have required on the ground that the estimated loss of economies was not substantial within the meaning of Clause (A)" (A. 16). The court of appeals, after accepting as "undeniable" that evaluation of losses of economies must be in relation to total revenues, expenses and income, added: "But we observe further that, where the statutory test of substantiality is understood in terms of potential harm to the investor and consumer, even these ratios are significant only as they affect the investment structure of the companies in the particular case, and different companies may be compared only on the assumption that both operate at the same level" (A. 57).

[10] We recognize that there are major elements of the total expense such as plant depreciation and cost of purchased gas over which management would have relatively little control.

The court then rejected the Commission's comparison of ratios in other cases where divestment was ordered, because it assumed that NEES's situation was unique (A. 58). On the assumption that it was dealing with certain and harsh consequences to investors, the court below thought respondents had made out a special case for leniency because in New England wholesale costs of natural gas are high and competition with fuel oil more difficult than in other parts of the country (A. 56).[11] The Commision, however, had noted that this is a problem common to all companies operating in New England and that other New England gas companies of comparable size had apparently been able to operate and "earn a fair return without the alleged advantages of common control with electric utilities by a holding company" (A. 17).

2. The Commission pointed out (A. 18 n. 24):

> Of 12 nonaffiliated Massachusetts gas companies which respondents selected for comparison with NEES, only one exceeded the NEES gas utility system in size of gross plant, gross annual revenues, and number of customers. It may also be noted that the NEES gas system is substantially larger than systems we have ordered divested in prior cases, such as those whose pertinent data are set forth in the Ap-

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[11] The marginal character of the natural gas business in New England can easily be exaggerated. Although costs were high compared to other sections of the country, NEES recognized that the advent of natural gas resulted in tremendous improvement in the profitability of its gas operations compared to the situation that prevailed when only manufactured gas had been available (see *supra* p. 6).

> pendix table. We found that several of those systems in turn were larger than companies that had demonstrated conclusively their ability to operate effectively free of holding company control. * * * [12]

The court of appeals rejected the relevancy of the first comparison on the ground that the fact "that the NEES gas companies together would be the second largest system in Massachusetts is a descriptive, not an analytical proposition," which "offers little help in assessing ability to survive" (A. 57).

Contrary to the view of the court of appeals, the fact that other non-affiliated gas companies in Massachusetts, all but one of which were smaller than the NEES gas system, have been able to operate successfully, was highly relevant in determining whether the NEES system, if divested, would also be able to do so. Nor is it surprising that other gas companies and other systems that the Commission had ordered divested, both of comparable size to the NEES system, have functioned effectively without holding company control. For the legislative history of the Public Utility Holding Company Act reflects congressional recognition that ordinarily it would only be in the case of small companies that a holding company could show "a real economic need" for retention of an additional system (H. Rep. No. 1903, 74th Cong., 1st Sess., 71).

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[12] In this regard the Commission cited *Philadelphia Co.*, 28 S.E.C. 35, 46–47; *Middle South Utilities, Inc.*, 35 S.E.C. 1, 11.

The Federal Trade Commission concluded its monumental study of public-utility holding companies—a study referred to in Section 1 of the Act—with a chapter concerning "Advantages and Disadvantages of Holding Companies to the Public." See S. Doc. 92, 70th Cong., 1st Sess., Pt. 72–A, 831 (1935). This summary pointed out that, apart from situations where the holding company might be responsible for the "development of connected operations * * * [and] the employment of larger and more efficient production plants," the strongest case for the holding company relationship rested on its ability to provide more expert and economical management for smaller companies (*id.* at 834). "Small, weak companies manifestly might benefit by association of interests, if they were placed in trustworthy and capable hands." *Id.* at 835.[13]

In its prior opinion in the case this Court quoted Senator Wheeler's statement that Section 11 was designed to permit the retention of additional systems that "were so small that they were incapable of independent economical operation * * *" (384 U.S. at 181, quoting 79 Cong. Rec. 14479). See, also, *North American Co.* v. *Securities and Exchange Commission,* 327 U.S. 686, 697, where the Court stated that

[13] See, also, the statement of Representative Wadsworth, an opponent of the Act, who criticized the prospective breakup of the Electric Bond & Share system (which he apparently believed—mistakenly—in 1935 still was a corporate vehicle for providing unified management to many small operating companies), on the ground that "[t]he chief injury is to the little operating company * * * ." 79 Cong. Rec. 10373.

Section 11 permits retention of only those additional systems that are "relatively small."

The NEES gas system is not small. As appears from the unchallenged portion of the Commission's findings, NEES provides gas service to about 237,000 customers in Massachusetts in an area of 660 square miles with a population of approximately one million (A. 4). The gross revenues from the sale of gas were $22,700,000 in 1958, the last year for which audited figures were available (A. 5). The Commission was justified in concluding that the gas system was not so small that it could not be divested without serious impairment to its economic health.

3. Despite the soundness of the Commission's conclusion that the ability of other Massachusetts companies to operate profitably undermined the significance of the Ebasco forecasts, the court below considered that it was the Commission's responsibility to address itself to the more remote consequences for future operations of the loss of net income and a correspondingly reduced rate of return on rate base. The court below would require the Commission to consider as "relevant factors" whether the consequence will be to render the raising of equity capital "difficult or impossible; * * * to raise the cost of borrowing money a little or a lot"—and if rate increases resulted whether they would "injure deeply, hurt slightly, or affect not at all the companies' ability to survive" (A. 5). The court below did not intimate whether in making such determinations the Commission could rely upon its own expertise, or would be limited to making the determination on the basis of expert testimony. In either

event the Commission would be wrestling with uncertainties far greater than those inherent in the forecasts themselves, and if this matter were to be resolved upon the basis of expert testimony the potentiality of delay would be considerable. Respondent had not attempted to address itself before the Commission to these remote consequences of the alleged loss of economies.[14] To require the Commission to do so would inject into Section 11(b)(1) proceedings a host of difficult and time-consuming rate-making issues, and in significant degree would shift the burden of proof in such proceedings from respondents to the Commission.

C. IN HOLDING THAT DIVESTITURE WOULD NOT ENTAIL THE LOSS OF SUBSTANTIAL ECONOMIES, THE COMMISSION PROPERLY GAVE SIGNIFICANT WEIGHT TO THE COUNTERVAILING COMPETITIVE ADVANTAGES THAT AN INDEPENDENT GAS SYSTEM WAS LIKELY TO HAVE

As this Court noted when the case was here before (384 U.S. at 183): "One of the evils that had resulted from control of utilities by holding companies was the retention in one system of both gas and electric properties and the favoring of one of these competing forms of energy over the other." The Court expressly

[14] Respondent itself urged before the Commission the impracticality of an attempt on the part of a holding company to address itself to the ultimate consequences of the claimed loss of economies, stating:

> Respondents have not attempted to argue that the NEES gas companies are incapable of independent operation in any absolute sense which could be mathematically demonstrated, simply because the question, particularly over any significant period of time, is inevitably affected by too many imponderables to be capable of mathematical demonstration. [Respondents' Reply Brief before the Commission, p. 37.]

noted that the Commission in this case had "found that any losses of economies would be offset by the benefits that would flow from the healthy competition between the independently controlled gas and electric companies" (384 U.S. at 179) and commented (*id.* at 184–185):

> Competitive advantages to be gained by a separation are difficult to forecast. The gains to competition might well be in the public interest and might well offset the estimated loss in economies of operation resulting from a separation of the gas properties from the utility system. This is a matter for Commission *expertise* on the total competitive situation, not merely on a prediction whether, for example, a gas company in a holding company system may make more for investors than a gas company converted into an independent regime.[15]

The court below quoted this language (A. 60), but in disregard of its clear import held that the advantage of competition is something the Commission is "entitled to take * * * into account as justifying a stringent test of 'substantiality.' But, that done, the general judgment has no independent significance in an individual case" (A. 61).

The language of this Court, quoted above, makes clear that offsetting benefits are relevant not merely to the formulation of the statutory standard for determining when the loss of economies is substantial—as the court of appeals suggested in its second opinion—

[15] Since this issue was squarely presented, and in our view squarely decided, when this case was last before the Court, we do not repeat here the arguments contained in our brief in No. 636, October Term, 1965, at pp. 34–38.

but to the application of the standard in a particular case as well.[16] Nor is it tenable that the Commission can take such benefits into account only in a case where they can be translated into a precise dollar figure. Such a requirement is impossible to comply with; to impose it is to deny any role to offsetting benefits. The requirement is also unsound. That the benefits of free and independent competition cannot be reduced to a dollar amount does not make them insubstantial or unworthy of consideration. A value judgment is indeed required, but that is precisely the kind of judgment which this Court on its earlier review of this case stated the Commission was empowered to make. In reading this factor out of Holding Company Act cases, the court below has refused to give effect to the policy of the Act and to the principles announced by this Court when the case was last here.

Once it is recognized that in weighing a holding company's claim to retain both electric and gas systems the Commission can give independent weight to intangible offsetting benefits of competition, we submit that this factor eliminated any possible doubt as to

[16] The Commission noted that seven Massachusetts gas companies that were not under common control with the electric companies had lower rates but significantly higher sales and revenues per customers than NEES; pointed out that "the determinations respecting the basic interests of the gas companies are made by NEES officials who occupy a dual position in which they must weigh the needs and objectives both of those companies and of the electric companies which represent the principal and most profitable business of the NEES system"; and concluded that it could not state "that a management solely interested in and devoted to the gas companies would not be able to advance them more effectively" (A. 20-21).

the validity of the Commission's conclusion that divestment of the NEES gas system would not entail the loss of substantial economies. On the undisputed facts, the Commission's decision was well within the area of a reasonable exercise of discretion, particularly in view of (a) the size of the NEES gas system, (b) the fact that such a substantial proportion of the economies claimed to be lost on severance were economies allegedly inherent in having common ownership of sizable gas and electric properties serving the same area, and (c) the inherent uncertainty of predicting loss of economies in the circumstances.

## CONCLUSION

The judgment of the court of appeals should be reversed and the case remanded to that court with instructions to affirm the Commission's order.

Respectfully submitted.

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No. 305

IN THE

# Supreme Court of the United States

October Term, 1967

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SECURITIES AND EXCHANGE COMMISSION, *Petitioner*

v.

NEW ENGLAND ELECTRIC SYSTEM, ET AL., *Respondents*

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*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT*

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**MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE AND PRESENT ORAL ARGUMENT AND BRIEF OF THE MUNICIPAL ELECTRIC ASSOCIATION OF MASSACHUSETTS**

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No. 305

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SECURITIES AND EXCHANGE COMMISSION, *Petitioner*

v.

NEW ENGLAND ELECTRIC SYSTEM, ET AL., *Respondents*

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## MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE AND TO PRESENT ORAL ARGUMENT

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The Municipal Electric Association of Massachusetts hereby respectfully moves for leave to file the annexed brief *amicus curiae* in this proceeding and to present oral argument.

The Municipal Electric Association of Massachusetts is an association formed by the boards and managers of thirty-nine of the forty municipal electrical utilities in Massachusetts. It was organized to promote the general welfare of member plants and to aid them in providing the lowest possible costs and the best possible service consistent with sound business principles. The Association's interest stems from the pendency before the Securities and Exchange Commission of two proceedings under Sections 6, 7, 9 and 10 of the Public Utility Holding Company Act,

in which authority is sought for the issuance of initial common stock by two nuclear electric generating corporations and the acquisition of such stock by certain sponsor electric utility companies and holding companies (*Vermont Yankee Nuclear Power Corporation,* SEC Docket No. 70-4435; *Maine Yankee Atomic Power Company,* SEC Docket No. 70-4419). These municipals have been denied an opportunity to participate in, or purchase bulk power from, the generating corporation and, therefore, seek to show in that proceeding that, absent an appropriate condition vindicating their rights, the applications must be denied under the standards of Section 10(b)(1) of the Act, because the denials are anti-competitive and restraints of trade, whether taken alone, or in connection with denial of access to other sources of low-cost bulk power.

There is a common issue in the instant Supreme Court proceeding and the pending nuclear generator proceedings before the SEC: the relative weight to be given by the SEC to the Act's theme of avoiding the evils of "restraint of free and independent competition" irrespective of whether it is applied to a divestiture or acquisition. (Section 1(b)(2), 15 U.S.C. § 79a(b)(2)).

The annexed brief contains a discussion of Federal Power Commission cases that have recognized the benefits of competition in the certification and merger of wholesale public utility systems. These decisions and opinions by an expert regulatory agency should be of assistance to the Court in dealing with this qualitative judgment. Accordingly, it is believed that the interests of the municipal parties in the *Vermont* and

*Maine Yankee* cases may be substantially affected by the ruling in the instant Supreme Court proceeding and they should, therefore, have opportunity to present their arguments herein as *amicus curiae*.

In the light of the importance of the outcome of this proceeding to the Association and its members, the Association also respectfully moves that it be allowed fifteen minutes of time for oral argument.

Respectfully submitted,

GEORGE SPIEGEL
*Attorney for Municipal Electric Association of Massachusetts*

IN THE

# Supreme Court of the United States

October Term, 1967

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No. 305

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SECURITIES AND EXCHANGE COMMISSION, *Petitioner*

v.

NEW ENGLAND ELECTRIC SYSTEM, ET AL., *Respondents*

---

## BRIEF OF THE MUNICIPAL ELECTRIC ASSOCIATION OF MASSACHUSETTS, AS AMICUS CURIAE

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### Preliminary Statement

When this Court, in *Securities & Exchange Commission* v. *New England Electric System,* 384 U.S. 176(1966), reversed the first decision of the court of appeals in this case, it recognized that the Public Utility Holding Company Act's phrase "without the loss of substantial economies" is not crystal clear but must be given "practical sense and application." One of the factors the Court's opinion stressed as bearing significantly on the application to be given the statute's phrase is the "theme of elimination of 'restraint of free and independent competition,'" which "runs throughout the Act."

The Massachusetts municipals believe that proper application of the Holding Company Act's pro-competition theme would be greatly aided by an examination of the decisions of the Federal Power Commission on the subject of inter-utility competition. It would seem reasonable, in evaluating the relative public-interest values of competition and common management, to consider the views of the federal agency whose members and staff are the experts on both natural-gas and electric-power utilities.

**Argument**

In a series of decisions and orders beginning at least as early as the 1947 order affirmed in *Panhandle Eastern Pipe Line Co.* v. *F.P.C.,* 169 F.2d 881 (1948), cert. denied, 335 U.S. 854 (1948), the Federal Power Commission has recognized the principle that competition has an important public-interest function even in a regulated public utility industry. In that case, the Commission authorized the Michigan-Wisconsin Pipe Line Company to construct and operate a natural-gas pipe line from Texas to the Great Lakes area, even though Panhandle Eastern Pipe Line Company was already operating just such a pipe line. The Commission summarized the advantages it saw in allowing Michigan-Wisconsin's entry, as follows:

> It will result in competition there, and will also make "available to the Michigan market an alternative service and supply of natural gas from the area of the largest gas reserves in the United States. That such an independent additional and reliable source of supply will be of great value to the area to be served and benefit public con-

venience and necessity admits of no doubt." 169 F.2d at 883.

Again, in *Transcontinental Gas Pipe Line Corp.*, 21 F.P.C. 138 (1959), wherein the Commission granted a certificate to Transco to sell gas to Lynchburg Gas Company as a second supplier, the Commission said (at page 404):

> We by no means intend to grant any company an exclusive right to serve a designated area, or to deny to consumers the benefits of more than one source of supply. Our objective is merely to protect the existing supplier from possible severe and unjustifiable harm resulting from the certification of an additional supplier, . . . .

The Commission's belief in competition as a useful tool in promoting efficiency and lower rates in public utility systems is forcefully expressed in four of its very recent opinions. In each of those opinions, the Commission has certified a second supplier of natural gas over the objection of the existing supplier and has found that the resulting competition will be beneficial to the public and so in the public interest. *Transcontinental Gas Pipe Line Corp.*, Opinion No. 493, June 8, 1966, 35 F.P.C. 917; *Columbia Gulf Transmission Co.*, Opinion No. 512, January 24, 1967; *City of Hamilton, Ohio*, Opinion No. 513, January 24, 1967; *Algonquin Gas Transmission Co.*, Opinion No. 522, June 27, 1967.

In the *Transco* case, Opinion No. 403, the Commission granted a certificate to Southern Natural Gas Company to serve part of the Chattanooga market, which previously had been served entirely by the existing supplier, East Tennessee Natural Gas Com-

pany. It is particularly significant that the Commission, in assessing the economic effect of establishing two suppliers for the market, gave consideration to the fact that:

> Southern's lower rates will permit Chattanooga [the distributor] to expand its sales and enable it to compete more effectively with alternative energy sources, particularly low-priced TVA *power*. (35 F.P.C. 917 at 914)

Here is clear recognition by the F.P.C. of the existence and importance of the very type of competition that would be made possible by the order entered by the Securities & Exchange Commission in the present case—competition between natural gas and electricity as alternative energy sources.

In the *Columbia Gulf* case, Opinion No. 512, a certificate was issued to Transco to supply part of the requirements of the Washington Gas Light Company, which previously had been served only by Atlantic Seaboard Corporation. The Commission acted over the strenuous objections of Atlantic Seaboard which, like the presiding examiner, considered that "Seaboard had fulfilled its public utility obligations to Washington, and that Transco's presence in Seaboard's market could be regarded as usurpation rather than competition for a market." (mimeo p. 4)

The Commission decision notes that, after Transco's competitive efforts were made, Seaboard introduced new rates "in order to permit the company to become more competitive." (mimeo p. 8) These lower rates were expected by the F.P.C. to increase sales and thus offset loss of sales. (mimeo pp. 8-9). "The Transco gas is cheaper and will produce substantial savings"

(mimeo p. 9), and "a pipe line has no vested interest in a market that must be perpetually protected by regulation." (mimeo p. 13) Although utilities may be "natural monopolies" the monopoly is not protected "where it is demonstrated that that competition would produce greater benefits to the public" (mimeo p. 13). Here "the potential competition afforded by Transco has already benefited the public interest and promises to do so even further in the future" (mimeo p. 14).

The effect of the FPC decision on natural gas rates in the Washington, D. C., area made newspaper headlines September 28 and 29, 1967, when the Washington Gas Light Company announced a resulting reduction in retail gas rates. As the Public Service Commission of the District of Columbia announced in its press release (Appendix A, hereto):

> These reductions in the Company's wholesale gas costs stem from recent Federal Power Commission proceedings involving pipeline gas rates and a new source of supply sought by the Company. As a result of those proceedings the Federal Power Commission approved new rates of Atlantic Seaboard Corporation which lowers the cost of gas to the local Company, and authorized the purchase by the Company of a part of its gas requirements from a new supplier, Transcontinental Gas Pipe Line Corporation. According to Chairman Avery, a substantial portion of the reduction in gas costs is attributable to the Company's success in obtaining the new source of supply, which the Public Service Commission had urged the FPC to authorize.

In the *City of Hamilton* case, Opinion No. 513, Texas Gas Transmission Company was certificated to supply part of the requirements of the City of Hamilton,

which previously had purchased its gas exclusively from Cincinnati Gas & Electric Company. The Commission commented:

> A natural gas company does not have a permanently fixed or vested interest in its existing markets. It should not be immunized from the forces of competitive operation within the natural gas industry. If the overall public interest will be better served by permitting a competing company to supply an existing market it should be permitted to do so.

Perhaps the most forceful demonstration of the FPC's judgment that competition at the wholesale level can be usefully employed in the public interest to control public utility rates occurred in the *Algonquin* case, Opinion No. 522. Asked by Algonquin for authority to construct and operate a lateral natural gas pipeline to render additional peak-day service to Hartford Gas Company, the Commission, *on its own motion,* directed Tennessee Gas Transmission Company to show cause why it should not be ordered to install and operate a parallel pipeline. After assessing the savings that would result from Tennessee's lower rates and assuring itself that the Connecticut Public Utilities Commission would see that these savings are passed along to the consumer, the Commission ordered Tennessee to begin operations as an alternative source of supply. When the Commission's attention was called to the fact that it had once allocated separate exclusive territories in New England to Tennessee and Algonquin, the Commission replied that its earlier action

> . . . necessarily created a potential for competition between the two companies. A division of markets was essential in the early 1950's if two independent companies were to survive. Needless

> to say, they have survived and prospered to the point where they are now in a position of being able to compete for the growing New England consumer load. Indeed, one beneficial result of the division was to insure that there would exist in the future viable alternate sources of supply available to serve the distribution customers in the New England market area. The growth of gas consumption in Hartford's general service area has caused this potential to be realized. . . .
>
> In two recent decisions we have made clear "that a pipeline has no vested interest in a market that must be perpetually "protected by regulation." *Columbia Gulf Transmission Company,* Opinion No. 512 (issued January 24, 1967), at p. 13. "A monopoly . . . should not be automatically and consistently protected where it is demonstrated that competition would produce greater benefits to the public." *Ibid.* See also *City of Hamilton, Ohio,* Opinion No. 513 (issued January 24, 1967), at pp. 8-9.

Nor has the Commission been unaware that a result of its certificating a second supplier in order to obtain the benefits of competition might have an adverse detrimental effect upon the existing supplier. To the contrary, such a contention was vigorously pressed by the existing supplier in each of the above cases and the Commission expressly recognized it to be "incumbent upon the Commission in any evaluation of a proposal [to authorize a second supplier] to consider whether [the] economic advantages would tend to be outweighed by economic disadvantage to the customers of [the original suppliers] by the withdrawal of the [distributor's] load." *City of Hamilton, Ohio, supra,* (mimeo, p. 5). Continuing, the Commission noted (*ibid.*):

> In approaching this aspect of the proceeding, we begin with the basic premise that *Lynchburg*

> [*Lynchburg Gas Co.* v. *F.P.C.*, 336 F.2d 942 (D.C. Cir., 1964)] established the test for evaluating the nature and scope of injury to be sustained by the loss of a particular load. The rule of *Lynchburg,* as we interpret that decision, makes it clear that no useful purpose is served by discussing in general terms, a loss in revenues or a simple reduction in rate of growth unless these circumstances are translated, by a proper showing, into proof of substantial actual detriment to the customers of [the existing supplier]. It is only this latter showing of detriment which can then be weighed in the balance against the established advantages to [distributors'] consumers in determining the overall public interest.

The FPC takes a similar position in connection with electric utilities, although that question has come up less frequently because of differences between the Natural Gas Act and the Federal Power Act.

In *Commonwealth Edison Co.,* Opinion No. 507, 36 F.P.C. 927, the Commission, in deciding whether to approve the merger of two electric power systems, felt obligated to "consider what effect, if any, our approval of a proposed acquisition will have on the existing and future competitive situation in the electric utility industry. . . . There is a legitimate public interest in the degree of concentration of economic power in American industries and, notwithstanding the safeguard of regulation, even in the electric utility industry." Although the Commission did approve the merger before it, since it combined companies "not in direct competition with each other," the Commission declared that "the general body of antitrust law is relevant to our considerations."

The FPC has thus found factually in case study after case study that regulation of monopoly is not an adequate substitute for competition. The Commission has found that the forces of competition benefit utilities as well as the public. Competition in the utility business need not be ruinous. On the contrary, it provides the motivation for rate reduction through cost reduction, and passes the benefits of efficiency along to the public. It applies to competition between gas and electric service just as the FPC has found it applicable to competition between two gas utilities and between two electric utilities.

Regulation adds up costs to determine the rate to be charged the public, but it does little to limit costs. Competition forces efficiency and cost reduction, ultimately lowering rates. Electric rates in New England are the highest in the country, and, we believe, a major cause is the lack of competitive incentive to reduce high costs and retire obsolete equipment.

## Conclusion

Accordingly, the judgment of the court of appeals should be reversed.

Respectfully submitted,

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## APPENDIX A

## PUBLIC SERVICE COMMISSION OF THE DISTRICT OF COLUMBIA

*FOR IMMEDIATE RELEASE*

## PRESS RELEASE

**Area Residents Will Pay Less for Gas**

Chairman George A. Avery of the Public Service Commission of the District of Columbia today announced a reduction of approximately $5,000,000 in charges to Washington Gas Light Company's 473,000 gas customers over the next 12 months. The reduction results from refunds and lower wholesale rates for gas purchased by the Company. About half of the $5,000,000 is applicable to past periods and will be reimbursed to customers in the form of reduced rates during the period October 1967 through September 1968. The remaining $2,500,000, Chairman Avery said, reflects lower wholesale supplier rates which also will be passed along to customers in the Metropolitan area in the form of further reductions in rates beginning in October 1967.

These reductions in the Company's wholesale gas costs stem from recent Federal Power Commission proceedings involving pipeline gas rates and a new source of supply sought by the Company. As a result of those proceedings the Federal Power Commission approved new rates of Atlantic Seaboard Corporation which lowers the cost of gas to the local Company, and authorized the purchase by the Company of a part of its gas requirements from a new supplier, Transcontinental Gas Pipe Line Corporation. According to Chairman Avery, a substantial portion of the reduction in gas costs is attributable to the Company's success in obtaining the new source of supply, which the Public Service Commission had urged the FPC to authorize.

The Company estimates that charges to a typical residential customer who heats with gas will be reduced by about $9.00 over the next 12 months. The reduction to residential non-heating customers will average about $1.80 over the same period.

September 27, 1967.

In The

# Supreme Court of the United States

October Term, 1967

No. 305

SECURITIES AND EXCHANGE COMMISSION,
*Petitioner,*
*v.*
NEW ENGLAND ELECTRIC SYSTEM ET AL.,
*Respondents.*

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

**OBJECTION OF RESPONDENTS TO MOTION OF MUNICIPAL ELECTRIC ASSOCIATION OF MASSACHUSETTS FOR LEAVE TO FILE A BRIEF AS AMICUS CURIAE**

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PRESS OF GEORGE H. DEAN CO., BOSTON

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1967

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No. 305

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SECURITIES AND EXCHANGE COMMISSION,
*Petitioner*,

*v.*

NEW ENGLAND ELECTRIC SYSTEM ET AL.,
*Respondents*.

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ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

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## OBJECTION OF RESPONDENTS TO MOTION OF MUNICIPAL ELECTRIC ASSOCIATION OF MASSACHUSETTS FOR LEAVE TO FILE A BRIEF AS AMICUS CURIAE

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The Respondents object to the motion of the Municipal Electric Association of Massachusetts for leave to file a brief as *amicus curiae*.

The Respondents withheld their consent to the filing of such brief for the reason that they saw no relevancy to the disposition of this case of the matters proposed to be pre-

sented in such brief, and no reason for doubting that all relevant facts and questions of law would be adequately presented by the parties. They find nothing in the motion or in the proposed brief annexed to it to cause them to reach a different conclusion.

Respectfully submitted,

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Ropes & Gray
*Of Counsel*

November 29, 1967

In The

# Supreme Court of the United States

October Term, 1967

No. 305

SECURITIES AND EXCHANGE COMMISSION,
*Petitioner*,

*v.*

NEW ENGLAND ELECTRIC SYSTEM ET AL.,
*Respondents.*

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

## BRIEF FOR RESPONDENTS

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* See Appendix A to this Brief.

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ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

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## BRIEF FOR RESPONDENTS

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### STATUTES INVOLVED

This case involves Sections 2(a)(29)(B), 11(b)(1) and 24(a) of the Public Utility Holding Company Act of 1935 (the "Holding Company Act") and Sections 557 and 706 of Title 5 of the United States Code (the Administrative Procedure Act as codified). The sections involved are set forth in Appendix A to this brief.

## QUESTION PRESENTED FOR REVIEW

The Respondents[1] submit that the basic question presented goes to the fundamentals of administrative law and procedure, and is properly stated as follows:

> Did the Court of Appeals err in deciding, on the basis of the record as a whole and after a fresh review of it, that the Commission's Findings and Opinion does not reveal the thorough examination and evaluation of the evidence and the careful application of expertise properly required of the Commission, and in remanding the case to the Commission for further proceedings?

The "basic question" stated by the Petitioner (Br. 2)[2]—whether the court below misapprehended the standard laid down by this Court for interpreting the "substantial economies" test under Section 11(b)(1)(A) of the Holding Company Act, and improperly shifted the burden of proof from the holding company to the Commission—is not raised by the record.

The Petitioner in no way questions the standard of "serious impairment" as stated by this Court and the court below, and there is now no definitional dispute. As to the application of this standard and the burden of proof, the court below explicitly stated that the holding company has the burden of proving loss of substantial economies under a stringent standard (A. 52)[2]; and nothing in its opinion even suggests that the burden of proof should be shifted from the holding company to the Commission.

The Petitioner also states three subsidiary "specific questions" as facets of the "basic" question (Br. 2-3). The

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[1] The Respondents are New England Electric System ("NEES") and subsidiaries (collectively, the "NEES System").

[2] In this brief, "Br." refers to Petitioner's Brief, "A." refers to the Appendix to the Briefs, and "R." refers to the transcript of record in SEC v. New England Elec. Sys., 384 U.S. 176 (1966) (October Term, 1965 No. 636).

first specific question assumes the answer when it states that the Commission found "serious deficiencies" in Respondents' study of the added costs of independent operation and so, impliedly, was entitled to reject the study in its entirety (Br. 2-3).

The Petitioner's second specific question is based on the assumption that the Commission found "that the separated [gas] system would have an adequate margin of revenue over costs for successful independent operation"; and suggests that the court improperly required the Commission to make "a specific determination as to the system's future rate of return" (Br. 3). The Commission did not make the assumed finding, and the court did not require the specified determination.

The Petitioner's third specific question is whether the Commission in deciding whether a loss of substantial economies will occur may consider offsetting advantages of independent operation without attempting to fix a specific dollar value therefor (Br. 3). The Petitioner implies that the court below answered this question in the negative and thus imposed a requirement impossible to comply with (Br. 3). What the court actually decided is something quite different. (See p. 33 below.)

## STATEMENT OF THE CASE

The Petitioner's "Statement" (Br. 4-10), so far as it pertains to the description of the NEES System and the historical facts of the case, is acceptable, but in other respects it reflects omissions, errors and unsupported assumptions, some of the more significant of which are the following:

1. The Statement omits the crucial holding of the court below, based on its review of the entire record, as to the

quality of the Commission's analysis of the evidence and its use of expertise in this case:

> "Even without the burden of proving likely demise,[3] petitioner's [NEES'] burden is, as the Court said, to meet 'a much more stringent test' than that of a probable significant loss. But, if the standard to be applied to petitioner is stringent, so is the level of analysis and expertise to be exercised by the Commission. We have, only after a fresh review of all the evidence in the light of this most stringent practical standard,[4] concluded that the Commission's opinion does not reveal that application of both reason and experience to facts which merits endorsement as the responsible exercise of expertise." (A. 52).

2. The Statement does not mention the important fact that, as the only basis for its finding that annual losses from severance of $1,098,600 are not "substantial", the Commission relied on a comparison with ratios in prior divestment cases (A. 16). The Commission made no analysis whatever of the relevance of the ratios nor of how the losses would affect the NEES gas companies. The Commission's rejection of the contentions of Respondents and the Massachusetts Department of Public Utilities (the "DPU") that the circumstances surrounding the NEES companies were

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[3] After this Court's decision in SEC v. New England Elec. Sys., *supra* note 2, the Commission on further hearing before the Court of Appeals indicated that it understood that the test of "loss of substantial economics" would be met only if the separated system would be "unable to stand by itself" (A. 51, 65). The court below carefully analyzed and then rejected this position, stating that a test based on mere ability to survive would read out of the Holding Company Act the phrase "without the loss of substantial economies", and would distort this Court's approval of the words "serious impairment" (A. 51-52). The Petitioner does not now take issue with that conclusion and apparently has withdrawn from the position it took before the court below. (See Br. 2, 11.)

[4] The words "most stringent" are italicized in the reproduction of the court's opinion in the Appendix (A. 52) but are not italicized in the report. See 376 F.2d at 111.

different was based solely on comparison with other Massachusetts operating companies (A. 17-18). The validity of the ultimate findings and the divestment order thus depend on the comparability of the companies compared and of their circumstances. There was substantial evidence of significant differences between the NEES gas companies and the other Massachusetts companies (R. 231-32, 591, 936-39), and no evidence of comparability, other than the fact that the other companies do business in Massachusetts. The Findings and Opinion, however, discloses no examination by the Commission of this crucial question.

3. Notwithstanding positive evidence to the contrary, including even one case of business failure (R. 591), the Findings and Opinion and the Statement in Petitioner's Brief seem to imply and proceed on the assumption that the other Massachusetts gas companies are independent and are operating profitably and successfully (A. 17, Br. 9). There is no finding to that effect and no evidence on which such a finding could be made. The numerous references in the Petitioner's Brief to such a finding (without record citations) (Br. 9, 10, 31, 33) emphasize its importance and underscore the seriousness of this deficiency in the Findings and Opinion.

4. The Petitioner's Brief and the Findings and Opinion refer to twelve nonaffiliated or independent Massachusetts gas companies "which respondents selected during the proceedings for comparison", and very clearly this alleged selection of twelve companies is the justification now advanced by the Petitioner for the Commission's reliance on statistics relating to those companies with no effort to determine their meaning or comparability. (See Br. 5-6, A. 18, 20.) The reference is not warranted. These twelve are gas companies or gas departments of combination gas and electric companies which operate in Massachusetts and have

over 5,000 customer meters (Res. Ex. 90; R. 656, R. Vol. III p. 1365).[5] An Ebasco witness testified that he had compared NEES' commercial cost figures per customer with others as a statistical check (R. 531). On cross-examination he refreshed his memory as to the names of the companies by reference to a working paper, and at the request of the Commission's counsel the working paper was subsequently put into the record (R. 557-61, 656). This was the entire extent of Respondents' alleged selection.

5. The Statement contains no reference to the fact that the Massachusetts Department of Public Utilities, which has jurisdiction over and regulates both gas and electric companies in Massachusetts, including all of the NEES gas companies, intervened as a party in the proceedings before the Commission and strongly opposed divestment of the gas companies. The Chairman of the DPU testified at length to the effect that in Massachusetts joint ownership or operation of gas and electric utilities is in no way contrary to public policy, that each case depends on its own circumstances, that 16 of 26 gas companies in Massachusetts (including NEES') are either combination gas and electric companies or under common control with electric companies, and that in the case of the NEES System there had been no suppression of one business in favor of the other. The view of the DPU was that divestment would be adverse to the interests of the residents of Massachusetts, and might necessitate increased gas rates; that it would not achieve any benefits but would result in the impairment of service and the loss of substantial economies; and that the

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[5] "R. Vol." refers to Volume III, IV, V or VI of the transcript of record in SEC v. New England Elec. Sys., *supra* note 2 (October Term, 1965 No. 636). These volumes contain the exhibits in the case including, in Volumes IV, V and VI, the Ebasco Report. (See Res. Ex. 58A, 58B, 91; R. 131, 564.)

loss would fall ultimately on the consumers (R. 41-42, 581-82, 587-94).

6. The Petitioner's Brief incorrectly states that Ebasco originally prepared its study on one theory and then "attempted to readjust its study" to a different theory and implies that this "changed basis" distorts the results (Br. 22-23). There was no change of theory and no readjustment. A brief reference to the proceedings before the Commission will clarify this.

The Commission's original order of notice initiating the proceedings specified *inter alia* three issues which appear relevant to this point (R. 20; see also R. 40-41):

(a) whether the System's electric properties constitute a single integrated system;

(b) whether the System's gas properties constitute a single integrated system; and

(c) whether both the electric and the gas properties may be retained in a single holding company system.

On the first issue, after extensive hearings, the Commission in its detailed Findings and Opinion concluded that the electric properties constitute a single integrated system (R. 27-38).[6]

When hearings were resumed, Respondents presented a detailed study summarized in the Ebasco Report, including pro forma operating statements of the gas companies, both individually and as a system, and a comparison of the two to determine whether operation as a single system would effectuate "substantial economies" and whether, subject to the applicable limitations of area and size, the gas companies could accordingly be treated as a single integrated system as defined in Section 2(a)(29)(B) of the Holding

[6] New England Elec. Sys., 38 S.E.C. 193 (1958).

Company Act. Since the Commission had not determined that question, it was necessary to compare operation of the gas companies as part of the NEES System with their operation both individually and as an integrated gas system separate from the NEES System. In his opening statement before the presentation of any evidence, Respondents' counsel explained the procedure and the order in which the evidence would be presented (R. 53-55), and that order was followed. The first witness also gave a description of the evidence as it was subsequently presented (R. 89-92). There was no readjustment or changed basis of the study.

7. The Commission in its Findings and Opinion must have relied on the Ebasco Report (the study submitted by Respondents referred to above) to support its concession that as Respondents contended the NEES gas companies operating together can effectuate "substantial economies" and thus constitute an integrated gas utility system within the meaning of Section 2(a)(29)(B) of the Holding Company Act (A. 3). Yet in determining the question whether the same NEES gas companies could be retained by NEES under Section 11(b)(1)(A) of the Holding Company Act, the Commission rejected the entire Report as unreliable (A. 14, 24). At no time has the Commission explained this inconsistent treatment of the Report.

8. The Petitioner's Brief states that NEES asserted its claim "under the exception provided by Clause (A) of Section 11(b)(1) which permits retention . . ." (Br. 4, 7). Clause (A) is not an exception, but is, along with Clauses (B) and (C), one of three conditions of the exception made by the proviso in Section 11(b)(1). This distinction is significant because later in its Brief the Petitioner attempts to reopen under Clause (A) the size requirement contained in Clause (C) (Br. 6, 31-33), as to which the Commission had specifically found that the requirement is satisfied (A. 7).

## SUMMARY OF ARGUMENT

If Respondents correctly understand the Petitioner's Brief, its main thrust is that studies and estimates made by experts, however competent, involve so many judgments and predictions that they are unreliable and of relatively little significance (Br. 19-21); that final judgment must be made by the Commission by application of its own general experience and expertise without particular reference to the individual circumstances of the instant case (Br. 26); that in making this judgment (after giving effect to the policy of the Act favoring competition by adopting a most stringent standard), the Commission may give such further weight to the assumed general benefits of competition as it thinks proper without any attempt to identify or evaluate specific benefits and in spite of uncontroverted evidence that in the particular case there will be no such benefits (Br. 35-36); and finally that its ultimate determination is for all practical purposes beyond judicial review (Br. 17).

Respondents take a fundamentally different approach. They do not question the Commission's broad expertise nor the importance of consistency in administrative practice, but they do question the ability of any commission with jurisdiction over such a wide and varied range of business activities to have such specific and detailed knowledge and expertise that it can properly rely thereon and reject in its entirety an imposing body of factual and expert opinion evidence such as was presented in this case.

Respondents suggest that highly specialized experts working in a narrow technical field may have greater expertise in that field and more intimate knowledge of the relevant facts than the Commission can have. They contend that the very purpose of the administrative process and the nature and scope of the responsibility delegated to the Commission impose on it the duty to deal with each case individually

on its own merits, to examine the facts of each case with meticulous care, to weigh the evidence in the light of its expertise and not attempt to substitute its expertise for the evidence, to accord to expert testimony the credence and weight to which the qualifications of the particular expert entitle it, to draw on the experience of other cases with care and to rely on precedents only after satisfying itself that the circumstances are comparable, and finally in its Findings and Opinion to set forth affirmatively all subsidiary findings necessary to support its ultimate conclusion, together with an adequate statement of its reasons and explanation of any apparent inconsistencies or departures from established principles, all in form to facilitate meaningful judicial review. Any relaxation of this standard of administrative performance would be a dangerous precedent.

Respondents' basic contention is that the Commission has not adequately addressed its attention and applied its expertise to the specific circumstances of this case, but has reached its conclusion wholly on the basis of the apparent similarity between certain mathematical ratios in this case and those in other cases (which the Commission has erroneously assumed were decided on the basis of those ratios), without examining or explaining the relevance of the cited ratios to the test of "serious impairment", and without taking into account differences in the circumstances which render the comparison irrelevant (A. 17).

More specifically, Respondents contend that neither of the reasons given by the Commission in support of its divestment order (A. 14, 17), namely, the alleged unreliability of the Ebasco Report and the finding that annual losses of $1,098,600 are not "substantial," is valid.

Respondents spared neither time nor money in making the Ebasco Report accurate and reliable. The work was done by leading experts in the field. Every aspect of it

was tested out in searching cross-examination. In the end, only two relatively small items were challenged, not on the basis of a claim of mistakes, but on the basis of a difference of opinion among experts (A. 13, 14). Even if valid, these would cast no shadow on the remainder of the report and would still leave losses of approximately $1,000,000 per year (A. 43-44). Further, in "conceding" that the gas companies are a single integrated system under Section 2(a)(29)(B), the Commission implicitly recognized the reliability of the Report (A. 3).

In holding that the loss of $1,098,600 would not be substantial, the Commission considered only the *size* of the loss ratios and declined to consider the *effect* of the losses on the future health and operations of the system. In brief, it acted by rule of thumb and refused to examine specific circumstances and apply its expertise to them.

The Petitioner's claim, asserted in its Brief but not mentioned in the Commission's Findings and Opinion, that estimates and pro forma statements are too speculative to be useful, is inconsistent with the Commission's regularly followed practice of requiring and relying on such studies and with its action in this case in resting its divestment order on a comparison of figures derived from just such studies in this and other cases (A. 16, 28).

Adoption of the "most stringent test" of substantial economies gives full effect to the policy of the Act in favor of separation. To allow unrestricted further use of this factor as an unlimited offset to proven losses would, as a practical matter, nullify judicial review.

The crucial determinations in this case depend so much on the particular facts and the character of the evidence relating to those facts that they can be adequately reviewed only in the light of a detailed examination of the whole record. This refers particularly to the determination of such issues as the reliability of the Ebasco Report, the validity

of the Commission's criticisms of certain aspects of the Report, the adequacy of the consideration accorded the views of the Massachusetts Department of Public Utilities and the testimony of its chairman, the significance of conditions peculiar to the NEES gas companies, the relevance of specific precedents and comparisons with other systems, and finally the significance of the demonstrable errors, omissions and inconsistencies in the Commission's Findings and Opinion. The court below has made such a complete examination of the record, and its decision should be affirmed.

## ARGUMENT

### Introduction

Respondents agree with a major part of Petitioner's Brief. They recognize that retention of an "additional system" represents a narrow exception to the general policy of the Act, that they have the burden of affirmatively bringing themselves within this exception, and that under the definition of "substantial economies" approved by the Supreme Court the test is stringent and their burden is a heavy one. They do not claim that the Commission has any duty to adduce evidence or remedy defects in their case and they recognize that within limits it is entitled to rely on its own experience and expertise.

Conversely, however, they contend that the Commission must direct its attention and apply its expertise to the specific facts of the individual case as established by the evidence and base its decision on those facts, and in this connection that it must apply its expertise specifically to analysis and prediction of the *effect* of anticipated losses on the future health and operations of the divested system.

Respondents submit that within these principles, on the record in this case, the Commission's performance has fallen short of an acceptable standard.

More specifically, Respondents contend that the Commission has failed to come seriously to grips with this case and has not given it the careful, individual attention which it requires, but has undertaken to dispose of it on the basis of general assumptions and precedents, and that this in turn has resulted in its improperly rejecting the Ebasco Report, ignoring the testimony and advice of the Chairman of the Massachusetts Department of Public Utilities, underestimating the handicaps under which the divested gas companies would operate, and finally holding that the loss of economies that would be sustained is not substantial. These deficiencies are aggravated by the absence of essential subsidiary findings and explanation.

1. The Commission Improperly Rejected the Ebasco Report.

The Ebasco Report is a three volume document summarizing in more than 500 pages of text and figures the results of a study made by Ebasco Services, Inc. in 1959-60. It analyzes in depth the existing operations of the NEES System and reports in detail on the feasibility and the effects of separating the eight NEES gas companies from the NEES System.[7] The Commission in its Findings and Opinion rejected the entire Ebasco Report; it held that no severance losses were proved (A. 14, 24).

The court below reviewed all the evidence, and flatly disagreed with the Commission: "the record here demonstrates *conclusively*", the court said, "that *some* increased costs are inevitable — the only doubt possible concerns the amount." (A. 54. Emphasis added.) That being so, the court said, the Commission could not order divestment without applying its expert judgment on the basis of some figure acceptable to the Commission (A. 54). Moreover, the court

[7] R. Vol. IV-VI. See note 5 at page 6.

pointed out, the Commission's reasons for rejection were based on errors and inconsistencies or went to minor points only; even if accepted, they left no doubt that a large residual showing was made by the Ebasco Report, and that significant severance losses are involved (A. 42-44).

The Petitioner now introduces in its Brief two theories not mentioned in the Commission's Findings and Opinion to support its rejection. First, the Petitioner suggests, the study is suspect as a readjustment made to meet new Commission requirements and, impliedly, to provide an unwarranted opportunity for the exercise of judgment by Respondents or Ebasco or both (Br. 22-23). Second, Petitioner urges that the Commission should have unlimited power to reject the Report because it is based on pro forma figures and projections (Br. 25-27). Petitioner's first theory has no basis in fact and is inconsistent with the record. (See pp. 7-8 above.) The second theory, an unlimited power of rejection, has no sound basis in law and is little more than a request by the Commission for *carte blanche* from the Court.

The quality of the Ebasco Report, the deficiencies of the Commission's analysis of it and the reasoning of the court below are the relevant factors. They clearly demonstrate the need for further examination and analysis on the part of the Commission, and so they clearly support the order of the court remanding the case to the Commission for that purpose.

### A. The Ebasco Report is a carefully prepared and reliable document which conclusively demonstrated significant losses.

Ebasco Services, Inc. is an independent utility engineering and consulting firm of wide experience and outstanding qualifications (R. 89, 96-100). The Commission in no way questions Ebasco's expertise and indeed recognizes its "ex-

tensive experience in the utilities field." (A. 10) A task force of Ebasco experts and the personnel working under their direct supervision spent more than 4,500 man-hours over a period of twelve months in the preparation of the Ebasco Report prior to commencement of the hearings (R. 100-06, 563-67, 667-68). The five Ebasco experts and six NEES System executives (including the President and the Treasurer of NEES and the head of the NEES Gas Division) testified in detail at lengthy hearings and were exhaustively cross-examined by counsel for the Commission's staff. All explanatory and supplementary data requested by the Commisssion's staff was supplied. The witnesses' expertise and detailed familiarity with the facts were clearly demonstrated.

The Ebasco Report and Respondents' related testimony and exhibits showed that, based on their 1958 operations, the eight NEES gas companies would incur measurable annual net operating losses of at least \$1,495,000 if severed from the NEES System and operated as eight separate companies, but that \$329,400 of these annual losses could be eliminated if after severance the gas companies were allowed to operate as a single system. A change in service company charges subsequently authorized would have reduced the loss by \$67,000. The Ebasco Report, adjusted to reflect this change, thus showed a minimum annual loss of economies in the amount of \$1,098,600 if the gas companies were operated together as a single independent system.

The Ebasco Report and the related evidence are the most extensive and thorough study of the consequences of holding company control and the prospective effect of severance that has ever been reported in a Section 11(b)(1) case. The court below has twice carefully reviewed all of this evidence and has concluded that on severance increased costs are inevitable (A. 54), and that even accepting all of the Commission's criticisms, "there is a large, residual showing in the Ebasco report." (A. 44) Significantly, even

the Commission has relied on the Report and the related testimony. It had no other basis for concluding that the NEES gas companies are a single integrated system, and it conceded that point (A. 3).

**B. Finding merely that the specific amount of losses claimed by Respondents has not been established, even if valid, would not dispose of the case.**

The Petitioner does not now challenge the holding of the court below that the record conclusively shows that increased costs are inevitable. It only argues that "even conclusive proof of some increased costs does not begin to meet [Respondents'] burden." (Br. 18)

But if it is undeniable that an increase in costs will occur, the Commission cannot be permitted to ignore that fact, even though as the Petitioner notes, the Respondents must meet "the burden of establishing an exception", and even though Congress anticipated that severance would usually cause some loss (Br. 18). In a case of this kind, the Commission must either determine an amount which it would regard as substantial and measure Respondents' case against that amount, or determine the amount proved by the Respondents and consider whether it is substantial. Comparing an undetermined amount of loss with an undefined standard of substantiality is too vague and indefinite to be useful.

As the court below noted, "if the Commission is to use its expertise to assess the impact of the costs in 'the total competitive situation', it must attempt to determine some acceptable figure as a predicate for its assessment." (A. 54) A determination that $1,098,600 has not been proved, without determining, for example, whether $1,088,600 has been proved, and if proved is substantial, does not dispose of the case. The Commission's rejection of the Ebasco Report with no assessment of the amount of losses proved would be

significant only in conjunction with a finding that *anything* less than $1,098,600 is not substantial. It cannot provide a separate basis for an order of divestment.

### C. The Commission's reasons for rejection of the Ebasco Report were not valid.

In its Findings and Opinion the Commission stated two reasons for its rejection of the Ebasco Report: first, "Ebasco's failure to consider employment of combined billing" by the gas companies after severance; and second, Ebasco's "inadequately explained disparate treatment of certain effects of severance on the gas and electric companies, respectively," in two Massachusetts communities where NEES provides gas and electric service (A. 14). These criticisms were both based on mistakes of fact and on invalid assumptions, and were inconsistent with the record. They are, moreover, in the aggregate, of minimal significance.[8]

As to the first criticism, relating to combined (or, more properly, centralized[9]) billing by the NEES gas companies

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[8] Petitioner also states in its Brief that the Commission found the estimated additional salaries and/or positions for the top executive staff of the gas system were suspect (Br. 24). Petitioner relies for this entirely on the court below (A. 53-54); the Respondents do not find the statement anywhere in the Commission's Findings and Opinion.

[9] Centralized billing would involve a billing center for the gas companies (with additional costs of transportation and communication and loss of part-time work in the smaller companies) which Ebasco considered marginal at best in view of the relatively small operation which could not justify a computerized operation (R. 898-902, 906-09). Combined billing would involve combining gas and electric billing operations as was done in NEES at six different locations (R. 528-29, 897). The Petitioner seems to suggest in its Brief that this still might be done after severance (Br. 20). The suggestion is inconsistent with the purpose of a Section 11(b)(1) proceeding which contemplates divestment and with the Commission's severance order in this case (A. 26).

after severance, the Commission's position as stated in its Findings and Opinion is not entirely clear. At one point it said, as indicated above, that Ebasco had failed "to consider employment of the combined billing procedures" (A. 14). At another point it said that Respondents had not "given any satisfactory reason why at least some form or forms of combined billing procedure could not be employed advantageously" (A. 13). Both statements are inconsistent with the record. Actually three qualified experts testified that the possibility of centralized billing was considered and rejected. The three witnesses testified respectively that centralized billing offered no realistic prospect for savings and would not be efficient, that it would not be important from a cost point of view, and that it would not result in any economy for the eight gas companies (A. 41-42, R. 569, 574, 735, 898-99, 901).

Whatever the Commission's meaning in its Findings and Opinion, the Commission there and again in its Brief quite inaccurately suggests that the item in question — customer billing — is a significant part of a broader function called customer accounting, which is one of the categories of cost analyzed in the Ebasco Report (A. 12-13, Br. 23).

The Findings and Opinion and the Brief both point out, correctly, that the personnel groupings under the customer *accounting* (as opposed to customer *billing*) category in the Ebasco Report represented $415,600 or approximately 40% of the estimated increase in costs (A. 12, Br. 23). The Commission paid no heed, however, to the abundant evidence in the record showing the small cost significance of customer billing as only a minor part of the overall customer accounting function (R. 527-32, 536, 552-54, 839-40, 857). The court below noted that while the Commission was purportedly criticizing a cost estimate of over $400,000, strictly it was speaking of a far smaller amount, perhaps

$60,000, only a portion of which could have been overstated. The court said:

"This brings us to what was the added billing expense, and hence the amount of error attributed to the Ebasco report because of its failure to assert the saving which, in the Commission's opinion, could be effected by having centralized billing. The Commission concluded merely that Ebasco's failure caused the estimate to be 'overstated.' It did not concern itself with discovering even what were the total increased billing costs, let alone the portion (obviously not the whole) which might be saved if centralized billing were adopted. It did find that the increased billing costs estimated for two of the eight gas companies, billing singly after divestiture, was $34,700 for the two. These companies covered more than half of NEES' gas customers. On a pro rata basis this would make the total billing increase for all companies $60,000. While doubtless such a projection is not precise, it seems significant that the Commission was not sufficiently interested to make any at all. Under the circumstances we do not think it unreasonable for us to point out that while the Commission was purportedly criticizing a cost estimate of over $400,000, strictly it was speaking of perhaps $60,000, only a portion of which could have been overstated." (A. 43)

The Commission's second reason for rejection of the Ebasco Report was alleged "disparities" in the increased costs attributed to NEES' gas and electric operations in Northampton and Lynn, Massachusetts (A. 13-14), and particularly, as stressed by Petitioner's Brief, in Northampton (Br. 23-24).

The cited comparisons are invalid in numerous respects. The evidence clearly indicated that allocation of the treasury and accounting work load at Northampton is effected by the payroll offset method under which an allocation is preserved overall, but not as to individual employees or groups of employees performing part of the job (R. 439,860-64). The pro forma organization was tailored to fit the new

situation. It necessarily varied materially from the existing pattern; and personnel categories bearing the same label varied widely in their make-up. The comparisons of customer accounting costs, which are a part of the treasury and accounting function, are therefore meaningless. They reflect neither the existing allocation nor the corresponding pro forma expenses. The Commission's comparisons of total treasury costs are subject to the same infirmity; they cover different personnel. The Ebasco witness, attempting to supply the relevant personnel and figures at the hearing, was cut off on this point by counsel for the Commission's staff, who acknowledged that he was cutting the witness off, and never returned to the subject (R. 864-65).

Perhaps the most dramatic error of the Commission, however, is its use of larger pro forma gas company figures which would apply only if Northampton were run as a separate company after severance, not as part of an independent gas system (Res. 58A; R. 131, R. Vol. IV pp. 625-27). In this respect, the Commission relies on figures which by reason of its own decision under Section 2(a)(29)(B) it had already rejected (A. 3, 10 n. 13).

On these points the Commission, in its brief to the court below, argued that correction of the errors would have resulted in only "slight" modifications and "could not be expected to alter in any respect the Commission's conclusions." The court did not accept this argument. It indicated only that as compared with its rejection of the Commission's criticism relating to centralized billing it "might have more sympathy with some, but not all, of the Commission's criticism" based on alleged disparities (A. 43). Nor did it "necessarily criticize the Commission for its skepticism in the specifics" (A. 54). Nonetheless, the court wanted further and careful analysis and explanation by the Commission, for it found no contention that the alleged accounting disparities could "remove from the Ebasco $472,000 cost estimate many sizable items." (A. 43)

**D. The Commission's expertise does not give it unlimited freedom to reject substantial, documented and uncontroverted expert evidence.**

In its Brief, the Petitioner urges a new theory, not suggested in the Findings and Opinion, in justification of the Commission's rejection of the Ebasco Report: the Report, the Brief argues, is a "hypothetical aggregate" of value judgments or business decisions (Br. 21) and that being so, the Commission cannot "be limited in its power to reject estimates which it finds unconvincing and which rest upon as many imponderables as those presented by NEES, merely because cast in the form of expert testimony." (Br. 26-27)[10] As legal support for this thesis, the Petitioner relies on *Market St. Ry.* v. *Railroad Comm'n,* 324 U.S. 548 (1945), in which this Court held that the due process clause had not been violated when the California Railroad Commission, which was intimately familiar with local conditions and history, lowered certain San Francisco cable car and other fares on the basis of its own conclusions formed without the aid of expert opinions. 324 U.S. at 560.

The Commission does not occupy a position in any way comparable to that of the California Railroad Commission in *Market Street Railway.* The Holding Company Act is but one of six acts administered by the Commission, whose current duties under the Holding Company Act have been described by a recent Chairman as "vestigial".[11] The Com-

[10] The Brief suggests, too, that the impact of severance would be very different if operating revenues were to increase in the future (Br. 29). The speculation about future revenues is significant. With the gas companies operating on a small margin, a small decline in revenues would have an even more dramatic but significantly adverse effect.

[11] Cary, *Administrative Agencies and the Securities and Exchange Commission,* 29 Law & Contemp. Prob. 653, 655 (1964). The other acts administered by the Commission are the Securities Act of 1933, the Securities Exchange Act of 1934, the Trust Indenture Act of 1939, the Investment Company Act of 1940 and the Investment Advisers Act of 1940.

mission is not familiar with local conditions applicable in this case and in reaching its decision, it has acted contrary to the views of the one participant in this case which does hold a position comparable to the California Railroad Commission's, namely the Massachusetts DPU, which regulates gas and electric utilities in Massachusetts, including the NEES companies. The DPU intervened before the Commission and, through its appearance, the testimony of its Chairman and its brief to the Commission, made clear that it concurred in the conclusions of the Ebasco Report and opposed divestiture as offering no advantages while imposing serious losses and creating the prospect of rate increases and the risk of dwindling sales (R. 41-42, 580-599). This expert analysis was also rejected by the Commission (A. 24-25).

There is another and perhaps even more significant difference between this case and *Market Street Railway.* There, as the Court noted, the Railroad Commission was "only receding, on experience, from steps it earlier had taken to advance the rate, which also had been regarded as experimental and as to which experience had disappointed expectations." 324 U.S. at 561. There is no such chance here for a second look and a change of heart. Once the divestment is ordered and carried out, the damage cannot be repaired, and the injury to consumers and investors cannot be restored. As the court below noted, the line of "serious impairment" is now drawn "close to the point of probable business failure." This "makes the holding company's burden of proof more difficult to carry but it also makes the risk more substantial that a divestment order based on erroneous findings will result in economic disaster." (A. 56)

The Commission's decision under Section 11(b)(1)(A) must always rest in part on estimates and calculations involving business judgment, since the test of "loss of substantial economies" necessarily requires a comparison of

operations under the existing organization with pro forma operations under a projected organization. The Respondents submitted a thorough, carefully documented and complete study prepared by recognized experts. Certainly the Commission may properly examine and question the conclusions of the experts who testified,[12] but neither the Commission's claim of expertise nor the difficulty of the decision can excuse the Findings and Opinion in this case which is seriously lacking in explanation, analysis and self-consistent findings based on the evidence. An agency's "*expertise* is not sufficient by itself. Findings supported by substantial evidence are required." *ICC* v. *J-T Transport Co.,* 368 U.S. 81, 93 (1961); 5 U.S.C. §§557, 706. In the present case, they are missing.

Much of Petitioner's Brief is devoted to an attempt to discredit severance studies in general, and the Ebasco Report in particular, and to justify substitution therefor of the Commission's general wisdom and expertise, on the ground that such studies involve business decisions and value judgments and that the use of precise figures produces an illusion of certainty which is misleading.

There are several answers to Petitioner's contention:

(i) The Ebasco Report is the kind of study the Commission routinely requires and relies on;

(ii) The Findings and Opinion does not even suggest any such "basic infirmity" as Petitioner now claims (Br. 21);

(iii) The Commission's decision in this case is actually and frankly based on comparison of figures derived from other severance studies; and

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[12] An expert's report may ordinarily be impeached only if his alleged errors are directly related to the other aspects of his testimony or are of so substantial a nature as to indicate carelessness or otherwise cast doubt on his qualifications. See Hoag v. Wright, 174 N.Y. 36, 43, 66 N.E. 579, 581 (1903).

(iv) The Respondents do not claim that the loss figures of the Report are exact but rather that they represent minimums and can safely be relied on as such. For obvious reasons, actual losses would undoubtedly be higher (R. 549, 555-56, 684-87).

If as the Petitioner argues, there is to be no limit on the Commission's freedom to reject expert testimony, the test under Section 11(b)(1)(A) will always rest in the sole discretion of the Commission, which will be free to reject all the evidence of projected losses and will remain completely immune from effective judicial review.[13] When a significant loss is proved conclusively, as it was here, the Commission cannot be allowed arbitrarily to reject the proof in its entirety. The court below properly did not attempt to supply the figures. It left that task to the Commission, and remanded the case for an adequate analysis and explanation by that agency.

2. The Commission's Holding That Losses In Excess of $1,000,000 A Year, In The Circumstances of This Case, Are Not Substantial Is Unwarranted.

**A. The divestment order is based on precedent rather than individual consideration.**

In its Findings and Opinion the Commission held as an alternative basis of its decision that losses to the NEES

[13] The court below held that the burden of persuasion to which a holding company may properly be held is "a fair preponderance of the evidence", rather than the special higher standard imposed by the Commission of "clear and convincing evidence", which is traditionally imposed in civil cases involving such matters as fraud, and also in denaturalization and expatriation cases and, more recently, deportation proceedings (A. 9, 31 n. 4, 54 n. 3). See Woodby v. Immigration and Naturalization Serv., 385 U.S. 276, 285 n. 18 (1966); McCormack, Evidence §320 (1954). With the position now taken by the Petitioner in its Brief that severance studies are inherently unreliable (Br. 19-21) and are subject to unlimited rejection (Br. 26), the Commission's special "clear and convincing evidence" standard can apparently never be met.

gas companies of $1,098,600 annually resulting from severance would not be "substantial" within the meaning of Section 11(b)(1)(A) of the Holding Company Act. The only reason given for this conclusion was that, expressed as ratios to the gas system's operating revenues, operating revenue deductions (excluding federal income taxes), gross income and net income before federal income taxes, the estimated losses for the NEES gas companies were "lower or not significantly higher than" similar ratios applicable to certain gas and electric properties ordered divested in prior cases (A. 16).

The court below found this summary treatment of the severance losses an entirely inadequate disposition. The ratios used by the Commission, the court said, have little relevance to the questions posed by the "serious impairment" test approved by this Court (A. 57, 58). Moreover, the figures drawn from the other cases were not in the record and were not dispositive of the issue in those cases (A. 58, 62-63). Finally, the court noted, the comparability of the circumstances of the other utilities cited — such matters as their market position, their rates of return and profitability — was in no way examined or established (A. 57-58).

As to the limited relevance of the ratios selected by the Commission, the court below noted that the "serious impairment" test now posed by this Court requires a careful examination of the effect of the losses on the particular companies involved, "in terms of the potential harm to the investor and consumer" (A. 57). The Commission's loss ratios do not answer the test, because the percentages have little meaning unless the rates of return are known and the likelihood of rate increases and financing problems can be assessed (A. 57-59). The Commission's ratios "are significant only as they affect the investment structure of the companies in the particular case, and different companies may be compared only on the assumption that both operate

at the same level." (A. 57)[14] In its Findings and Opinion the Commission in no way examined these critical economic questions.

As to the immateriality of the figures taken by the Commission from prior cases, the court noted that the "comparison-of-ratios test" was first used by the Commission in *Philadelphia Co.*, 28 S.E.C. 35 (1948), as "nothing more than the normal decisional technique of referring to and comparing the facts in prior decisions as a guide", not for the purpose of disposition as stated by the Commission; and that the figures selected by the Commission for comparison in *Philadelphia* were "either ignored or considered mere makeweights in the earlier cases, except in a few where the percentages were so small as to demonstrate that the claimed losses were *de minimis.*" (A. 58 n. 6)

The court carefully elaborated this analysis in an appendix attached to its opinion (A. 62-63), and further cautioned the Commission that the court "must disapprove entirely of the practice adopted by the Commission after 1948 of comparing the ratios before it with similar ratios derived, not from the opinions in previous cases, but from the papers and records in its files." (A. 62) As a supplement to the court's appendix, Respondents are attaching an appendix to this brief (Appendix B) analyzing in detail the losses cited in divestment cases specified by the Commission (including *Philadelphia*). It can be seen from this Appendix that five of the seven

[14] For these reasons, the Commission's comparisons of operating ratios (operating revenue deductions as a percentage of operating revenue) are equally irrelevant since, as the court noted, "a business may operate relatively efficiently, yet at a level too low to attract investors." (A. 58) In general, operating ratios are used by financial analysts and regulatory bodies in the utility field not as a guide to rate making but to afford "a measure for determining the efficiency with which the enterprise is conducted and while its value is greater in comparing the year to year trend it has a limited use in comparing verv similar enterprises." MOODY'S PUBLIC UTILITY MANUAL, p. ix (1967).

divestment orders cited by the Commission in the Appendix to its Findings and Opinion were based not on a finding that the claimed loss of economies was not substantial, but on the fact that the Commission had not believed the estimates or that the estimates failed to show the amount of lost economies. The other two, possibly relevant, involved dramatically smaller loss ratios.

The third defect in the Commission's comparison-of-ratios test, as specified by the court, was the absence of any basis of comparability between the other utilities divested and the gas companies involved here. A glance at the other cases (see the Commission's Appendix A. 28, or this brief's Appendix B) shows that the Commission was using, for example, ratios involving a gas company in Virginia in 1940, a Pennsylvania electric company in 1949, and a Louisiana gas company in 1954. The relevance of these is inherently doubtful and in any event was in no way explained by the Commission. The court below summed it up as follows:

> "We do not think that the Commission's obligation, which is at the root of the respect to which its expertise is entitled, is satisfied by the invocation of largely irrelevant ratios or of other data concerning other companies, at other times, in other areas, facing possibly different conditions." (A. 59)[15]

The court below was equally dissatisfied with the Commission's cursory and inadequate comparison of NEES with other companies in Massachusetts, and with the Com-

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[15] The Petitioner in its Brief inaccurately states that "the court . . . rejected the Commission's comparison of ratios in other cases where divestment was ordered, because it assumed that NEES's situation was unique", and that acting "on the assumption that it was dealing with certain and harsh consequences to investors" it thought that the Respondents "had made out a special case for leniency" (Br. 30). The court's actual reasons for rejecting the comparison-of-ratios test are summarized above and are amply stated in its opinion (A. 57-59).

mission's reliance on their supposed successful operation as a reason for believing that the NEES gas companies would also be able to perform satisfactorily after severance (A. 17-18, A. 56-58). The Commission assumed with no evidence, that the other companies in Massachusetts used for comparison (i) were independent, (ii) were subject to the same competitive conditions, (iii) were able to compete effectively with oil and (iv) were capable of economical operation.[16] The validity of every one of these assumptions was essential to the validity of the comparisons. Yet there is no evidence in the record to support any of them, and in fact, there is clear and explicit exidence controverting each. These so-called "independents" involve a variety of affiliations, connections, combinations of gas and electricity and other arrangements.[17] Their franchise areas are materially different in significant ways (R. 509, 591, 937-39). Some of them are experiencing economic problems and the Chairman of the DPU testified that there had been one recent bankruptcy (R. 591).

### B. The Commission has failed to examine the prospective effect of separation.

Losses of $1,098,600 annually would, unless rates are increased, reduce the net income of the NEES gas companies

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[16] The Petitioner's Brief asserts that the NEES gas system is the second largest in the New England region (Br. 9) and stresses (more narrowly) that the Commission found it the second largest in Massachusetts (Br. 30-31). As the court below noted, however, "The record here is silent on the economic health of the largest system." (A. 57).

[17] The Commission introduced limited evidence at the hearing concerning the numbers of customers, sales and revenues of nine of

before federal income taxes by 30% and would reduce the rate of return on invested capital to 4.1% (A. 57-58). There was voluminous evidence as to the adverse economic effect of a rate increase, the absence of any offsetting financial benefits to be anticipated from independent operation, and the handicaps peculiar to the franchise areas under which the NEES gas companies operate (R. 509, 696, 722-24, 739, 756-58, 937-39). On the basis of this evidence and by the application of its general experience and expertise, the Commission could have formed a reasonable estimate of the effect of the losses on the economic health of the system, applying the tests suggested by the court below or other tests selected by the Commission.[18] The fact that resolving

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the twelve Massachusetts companies (Div. Ex. 4A-4D; R. 946, R. 1447-52). Of the nine gas companies so selected by the Commission, only three are independent; and the record shows that the Division was aware that at least some of these companies were not "independent" (R. 1246; Res. Ex. 57; R. 85, 1310; MOODY'S PUBLIC UTILITY MANUAL, pp. 68, 71, 72, 80, 103, 127, 138, 278, 858, 1278, 1284 (1959); R. 177). On direct examination the Staff's witness who introduced this evidence explained why two of the nine companies were not considered comparable (R. 944-45). On cross examination the witness admitted that he did not know whether the remaining seven non-affiliated gas companies followed the same practice of reporting domestic gas sales as did NEES, that other factors would have to be considered to determine the value of the comparisons, that no comparisons of insurance cost per customer had been made, and that though his figures did not reflect the percentage of the total which was represented by interruptible sales, that percentage would be a significant factor in evaluating a company's MCF per customer record (R. 1241-47). The Commission itself in prior cases has recognized the marginal value of generalized comparisons of this kind. See North American Co., 18 S.E.C. 459, 464-65, 611, 617 n. 10 (1945); Northern States Power Co., 36 S.E.C. 1, 9 (1954).

[18] The court below expressly left to the Commission the selection of relevant factors to be considered (A. 59). It in no way required the Commission "to make a specific determination as to the system's future rate of return," as implied by the Petitioner's second specific question (Br. 3).

the question on the basis of expert testimony may be less convenient and result in some delay, as suggested in Petitioner's Brief (Br. 34), does not relieve the Commission of this duty.

3. The Court Below Correctly Interpreted the Weight This Court Attributed to the Assumed Benefits of Separate Operation.

**A. The claim that the assumed general benefits of competition can be used a second time in testing substantiality is novel and its validity has not been decided by this Court.**

The Petitioner now takes the position that the assumed benefits of independence may be taken into account first in the formulation of the standard of substantiality and then again in meeting that standard, and undertakes to find support for that position in the prior decision of this Court. Petitioner's Brief goes so far as to claim that this issue of double use was squarely presented and squarely decided by this Court at that time (Br. 35 n. 15). This is not borne out by the record and is contrary to the position previously taken by the Petitioner.

The only question presented to this Court when it first considered this case was, as set forth in the Petition and both briefs, the *meaning* of the statutory phrase "loss of substantial economies,"—how the phrase was to be interpreted and nothing more. The Petitioner was then urging a most stringent test, not within the normal meaning of the words, on the ground that the policy of the Holding Company Act favoring free competition could not be given effect in any other way because of the difficulty of placing a dollar value on the benefit. It stated its position in its brief (p. 38) thus:

"The Commission's interpretation of 'substantial economies,' however, avoids these difficulties and permits the

agency to give effect in a meaningful way to the very real, although immeasurable, substantial competitive advantages that result from elimination of common holding company control of gas and electric systems without being required to perform the impossible task of making dollar predictions about an issue that is incapable of such precise definition."

There was not even a suggestion of further use of this factor. Reflecting it in the test of substantiality to produce a "most stringent standard" was apparently considered to be wholly adequate to effect the policy of the Holding Company Act.

Similarly, in this Court's consideration of the case, it is reasonable to assume that the Court thought of the policy of the Holding Company Act and the probable benefits of competition only as they bore on the question before it, namely, the interpretation of the statutory term.

An examination of the opinion confirms this assumption. After referring to the legislative history as suggesting a more stringent test than the lower court's business judgment test, the opinion dealt with the impact of "the theme of elimination of 'restraint of free and independent competition'." *SEC* v. *New England Elec. Sys.*, 384 U.S. 176, 183 (1966). In this connection it commented on the difficulty of forecasting competitive advantages and the necessity of leaving this to the Commission's expertise, and concluded that the Commission's construction of the statutory phrase in exercise of its expertise was within the permissible range. 384 U.S. at 184-85.

In this context the Court's comments were obviously intended to relate only to the question with which the Court was dealing, the meaning of "substantial economies". The Court was simply defining the test, not considering how it could be satisfied.

**B. Authorization to give unrestricted effect to the assumed benefits of competition would provide the Commission *carte blanche* without any opportunity for court review.**

Petitioner's Brief points out that once the Commission's right to give independent weight to the benefits of competition (that is, to offset them against proven losses without identifying and evaluating specific benefits) is recognized, the Commission's conclusion that divestment would not entail the loss of substantial economies becomes unassailable (Br. 36-37). This would always be so, and therein lies the danger.

If loss of economies, otherwise meeting the test, can be offset by a general reference to the benefits of free competition without any determination of the reality or approximate value of those benefits, or the extent to which they offset proven losses, then the Commission has absolute power to order divestment in any case it desires, and the right of judicial review which the Holding Company Act purports to give becomes, as a practical matter, a nullity. Any amount of carefully prepared factual evidence and expert opinion, even if uncontroverted, goes for naught. Whatever the amount of the lost economies, the Commission can brush them aside with the simple statement that they are offset by the benefits of competition. This is a prerogative which the Petitioner now seeks (Br. 17), but this result could hardly have been intended by the Congress. A more reasonable application of the statute must be found.

Admittedly the dollar value of the competitive advantages to be gained by separation is difficult to forecast (A. 60). Yet the loss of economies which determines retainability of an additional system has to be expressed in dollars, and any item entering into the computation of the net loss, or used as a set-off against proven loss, must of necessity be similarly expressed.

In the present case there is ample uncontradicted evidence that no offsetting advantages could be expected from severance. There is also ample uncontradicted evidence to show why an increase in expense of the magnitude involved would be peculiarly important and serious for these gas companies. There appears to be no previous case in which the Commission has felt free to draw inferences contrary to evidence of this kind without specific contrary evidence as a basis for such inferences.

### C. The lower court's formula is a reasonable answer.

The formula adopted by the lower court in carrying out this Court's mandate is sound and consistent with this Court's decision. The general policy of the Holding Company Act is given effect without specific evaluation by establishing a most stringent standard of "serious impairment," thus permitting construction of the phrase "substantial economies" in a way which is not within the normal meaning of the words used and thereby giving significant weight to the policy.

Then if it is found that separate operation can be expected actually to reduce the net losses either by increasing income or by reducing expenses in an amount that can be reasonably predicted, whether because suppression of competition will be ended or for some other identifiable reason, the approximate amount of increase in income or reduction of expenses can be offset against the loss of economies. On this basis the benefit of competition becomes one of the items in the calculation of the net loss of economies.

In a case such as the instant one, where any actual benefits from separation are highly speculative and the evidence indicates that there will be none, giving any further effect

to purely theoretical benefits than this Court has already approved in defining the standard appears unnecessary and unwarranted.

4. THE COURT BELOW DID NOT ERR IN REMANDING THE CASE TO THE COMMISSION FOR FURTHER PROCEEDINGS.

**A. On review of the entire record, the court below found serious errors and deficiencies.**

In determining whether the Commission's Findings and Opinion meet the standards generally imposed on administrative agencies, that is, whether the findings are supported by substantial evidence in the record as a whole, whether the ultimate conclusions are based on adequate subsidiary findings and articulated reasoning, and whether the Findings and Opinion represent a careful and consistent application of expertise, the court below found numerous and serious deficiencies which not only warranted but indeed required a remand of the case to the Commission.

These deficiencies and errors in the Findings and Opinion included the following:

(i) With no explanation the Commission, for purposes of Section 2(a)(29)(B) of the Act, relied on the Ebasco Report while, for purposes of Section 11, it rejected the same Report in its entirety as unreliable (A. 3, 14, 24, 38 n. 8).

(ii) The Commission held that no severance losses had been proved, whereas based on unchallenged evidence and the whole record there could be no doubt that significant losses were conclusively proved (A. 14, 24, 43-44, 54).

(iii) The Commission's analysis of increased accounting costs resulting from severance rested on demonstrably false assumptions and inaccurate figures which could have resulted only from a failure on the part of the Commission to examine the record carefully and thoroughly. (See pp. 17-19 above.)

(iv) In holding the projected loss of economies insubstantial, the Commission relied on a comparison with ratios in prior cases which were based on erroneous figures and which had no demonstrated relevance or comparability to this case (A. 16, 28, 57-58, 58 n.6, 62-63 and Appendix B to this brief).

(v) The Commission in no way attempted to analyze the effects of severance on the NEES gas companies to determine whether their operations would be seriously impaired (A. 54-59).

(vi) The Commission assumed that other Massachusetts gas companies are independent, operate successfully and earn a fair rate of return, despite the uncontroverted evidence in the record that they are not all independent, that all are operating on a small margin and that there has already been a bankruptcy. (See pp. 27-28 above; A. 57-58.)

(vii) The Commission assumed the comparability of other gas companies to the NEES companies on no basis in the record except that they are in the same state (A. 56-58).

**B. The determination of the court below should not be disturbed in the absence of an affirmative showing that it was clearly wrong.**

Congress has placed with the Courts of Appeals the duty to review administrative agency decisions and to determine whether they are supported by substantial evidence and otherwise comply with applicable legal requirements. *Universal Camera Corp.* v. *NLRB*, 340 U.S. 474, 490-91 (1951); *FTC* v. *Standard Oil Co.*, 335 U.S. 396, 398-401 (1958); 5 U.S.C. §706, 80 Stat. 393; Section 24(a) of the Holding Company Act. The court below in carry-

ing out this duty has required that the findings of the Commission be reasonably consistent with the substantial evidence in the record as a whole, as applied to the statutory standard laid down by this Court (A. 54, 42-45), and that they be sufficiently articulated and particularized to enable the reviewing court to determine whether and how the Commission has applied its expertise. See *Secretary of Agriculture* v. *United States,* 347 U.S. 645, 654 (1954). Having found that the Commission's Findings and Opinion are inconsistent with conclusive evidence in the record, the court has properly remanded the case for further examination by the Commission.

In general, the Commission argues that its expertise is a sufficient answer but, as this Court has said, "*expertise* is not sufficient by itself." *ICC* v. *J-T Transport Co.,* 368 U.S. 81, 93 (1961). "Expert discretion is the lifeblood of the administrative process, but 'unless we make the requirements for administrative action strict and demanding, *expertise,* the strength of modern government, can become a monster which rules with no practical limits on its discretion.' *New York* v. *United States,* 342 U.S. 882, 884 (dissenting opinion)." *Burlington Truck Lines, Inc.* v. *United States,* 371 U.S. 156, 167 (1962).

A clear understanding of the deficiencies in the Commission's Findings and Opinion necessarily depends on a review of the entire record — the 1,200 pages of testimony and the four volumes of exhibits, including in particular the three volumes of the Ebasco Report. The court below has undertaken this heavy task twice, and the five judges who have participated have all reached the conclusion that the Commission has not performed its job in this case. This Court ought not to be obliged to examine and evaluate the entire record, and yet in the end that is what it must do to satisfy the requests of the Petitioner. This Court's power to review the correctness of the application of the standard of substantial evidence in light of the entire

record "ought seldom to be called into action." *Universal Camera Corp.* v. *NLRB, supra* at 490. The Court "will intervene only in what ought to be the rare instance when the standard appears to have been misapprehended or grossly misapplied", *id.* at 491, and the Court, if it does review, will do "no more on the issue of insubstantiality than decide [whether] the Court of Appeals has made a 'fair assessment' of the record." *FTC* v. *Standard Oil Co., supra* at 401; See *NLRB* v. *Pittsburgh S.S. Co.,* 340 U.S. 498, 502-03 (1951). Respondents submit that the Court of Appeals has made a demonstrably fair assessment of the entire record, and that its opinion and order are amply supported and justified, and indeed required in light of the record and the deficiencies in the Findings and Opinion.

## CONCLUSION

For the reasons stated, the judgment of the Court below should be affirmed.

Respectfully submitted,

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December 22, 1967

## APPENDIX A

### STATUTES INVOLVED

SECTIONS 2(a)(29), 11(b)(1) (A)-(C), AND 24(a) OF THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935.[1]

SECTION 2. (a) When used in this title, unless the context otherwise requires —

. . . .

(29) "Integrated public-utility system" means —

. . . .

(B) As applied to gas utility companies, a system consisting of one or more gas utility companies which are so located and related that substantial economies may be effectuated by being operated as a single coordinated system confined in its operations to a single area or region, in one or more States, not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation: *Provided,* That gas utility companies deriving natural gas from a common source of supply may be deemed to be included in a single area or region.

SECTION 11

. . . .

(b) It shall be the duty of the Commission, as soon as practicable after January 1, 1938:

(1) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such action as the Commission shall find necessary to limit

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[1] 49 Stat. 810, 820-21, 834-35 (1935), as amended, 15 U.S.C. §§79b(a)(29)(B), 79k(b)(1) and 79x(a) (1964).

the operations of the holding-company system of which such company is a part to a single integrated public-utility system, and to such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of such integrated public-utility system: *Provided, however,* That the Commission shall permit a registered holding company to continue to control one or more additional integrated public-utility systems, if, after notice and opportunity for hearing, it finds that—

(A) Each of such additional systems cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system;

(B) All of such additional systems are located in one State, or in adjoining States, or in a contiguous foreign country; and

(C) The continued combination of such systems under the control of such holding company is not so large (considering the state of the art and the area or region affected) as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation.

SECTION 24.

SECTION 24. (a) Any person or party aggrieved by an order issued by the Commission under this title may obtain a review of such order in the United States court of appeals within any circuit wherein such person resides or has his principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the entry of such order, a written petition praying that the order of the Commission be modified or set aside in whole or

in part. A copy of such petition shall be forthwith transmitted by the clerk of the court to any member of the Commission, or any officer thereof designated by the Commission for that purpose, and thereupon the Commission shall file in the court the record upon which the order complained of was entered, as provided in section 2112 of title 28, United States Code. Upon the filing of such petition such court shall have jurisdiction, which, upon the filing of the record shall be exclusive, to affirm, modify, or set aside such order, in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission or unless there were reasonable grounds for failure so to do. The findings of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If application is made to the court for leave to adduce additional evidence, and it is shown to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceeding before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 346 and 347 of title 28.

SECTIONS 557 AND 706 OF TITLE 5 OF THE UNITED STATES CODE (THE ADMINISTRATIVE PROCEDURE ACT AS CODIFIED):[2]

SECTION 557. . . . .

(c) Before a recommended, initial, or tentative decision, or a decision on agency review of the decision of subordinate employees, the parties are entitled to a reasonable opportunity to submit for the consideration of the employees participating in the decisions —

(1) proposed findings and conclusions; or

(2) exceptions to the decisions or recommended decisions of subordinate employees or to tentative agency decisions; and

(3) supporting reasons for the exceptions or proposed findings or conclusions.

The record shall show the ruling on each finding, conclusion, or exception presented. All decisions, including initial, recommended, and tentative decisions, are a part of the record and shall include a statement of —

(A) findings and conclusions, and the reasons or basis therefor, on all the material issues of fact, law, or discretion presented on the record; and

(B) the appropriate rule, order, sanction, relief, or denial thereof.

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[2] 80 Stat. 387, 393 (1966), 5 U.S.C. §§557(c), 706 (Supp. II, 1965-66). The laws relating to the organization of the Government of the United States and to its civilian officers and employees, generally, including the Administrative Procedure Act, were revised, codified and enacted as Title 5 of the United States Code on September 6, 1966, by Pub. L. 89-554, 80 Stat. 378. The provisions of the Administrative Procedure Act relevant to this case were not substantially changed.

SECTION 706.

To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall —

(1) compel agency action unlawfully withheld or unreasonably delayed; and

(2) hold unlawful and set aside agency action, findings, and conclusions found to be —

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;

(B) contrary to constitutional right, power, privilege, or immunity;

(C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right;

(D) without observance of procedure required by law;

(E) unsupported by substantial evidence in a case subject to sections 556 and 557 of this title or otherwise reviewed on the record of an agency hearing provided by statute; or

(F) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court.

In making the foregoing determinations, the court shall review the whole record or those parts of it cited by a party, and due account shall be taken of the rule of prejudicial error.

## APPENDIX B

### ANALYSIS OF PRIOR DIVESTMENT CASES RELIED ON BY THE COMMISSION

Five of the seven divestment orders cited in the Commission's Appendix to its Findings and Opinion (A. 28) are based on the fact that the Commission did not believe the estimates or that the estimate failed to show the amount of lost economies. The other two involve substantially smaller loss ratios.

The five cited precedents which are irrelevant are:

1. *Gulf States Utilities Company (1940 figures).* Gulf States' gas properties were ordered divested in *Engineers Public Service Co.,* 12 S.E.C. 41 (1942), on the ground that the amount of increased expenses claimed did not constitute, to quote the opinion, "lost economies arising from the independent operation of the gas system, since it ignores compensating factors. These asserted losses represent 8.7 percent of the gas department's expenses, 25.6 percent of its gross income, and 32.6 percent of its net income for 1940. We believe, however, that as estimates of lost economies they are in several respects overstated."[1] The Commission noted various overstatements and concluded that it could not find that the economies lost would be substantial. The case was decided on the ground that the claimed losses had not been proved, and apparently if they had been, they would have been considered substantial. 12 S.E.C. at 81.

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[1] 12 S.E.C. at 80. It will be noted that these percentages are higher than those stated in the Appendix to the Commission's Findings and Opinion. The reason apparently is that the Commission has restated the figures in this and other cases to eliminate the effects of Federal income taxes. Respondents cannot verify the accuracy of the adjustments.

2. *Virginia Electric and Power Company (1940 figures).* Virginia's gas properties were also ordered divested in *Engineers, supra.* The Commission stated that the $71,500 of increased annual expenses claimed, "if accurate and in the absence of any benefits resulting from separation, afford an impressive basis for finding a loss of substantial economies . . . ." 12 S.E.C. at 59. However, the Commission found the increased expenditures "excessive," and concluded that "with respect to the gas properties alone, the record, if given its most liberal interpretation, would not sustain a finding of more than one-half the claimed increased expenses. We further conclude that the loss of economies would in fact be less than such increased expenses." 12 S.E.C. at 59, 60. The Commission's Appendix deals with this case by cutting the claimed losses in half and stating them as $35,750. Clearly, in light of the holding, the figures have to be cut by more than half, and equally clearly the holding was not that the claimed losses were not substantial nor that one-half of the claimed losses was not substantial. The holding was that the claimed losses had not been proved.

3. *St. Louis County Gas Company (1942 figures).* St. Louis County Gas was ordered divested in *North American Co.*, 18 S.E.C. 611 (1945), because to accept the $160,900 estimate of increased expenses "without further inquiry would be to distort the Act". 18 S.E.C. at 615. "Ultimately, the issue" was not the substantiality of the losses but "whether experience [would] bring about the increased costs claimed by the respondents without offsetting benefits." 18 S.E.C. at 617. The Commission found that the claimed losses did not take account of the probability of offsetting advantages and could not be found to reflect the over-all loss of economies. If they had, the case would apparently have been decided in favor of retention.

4. *Jersey Central Power and Light Company (June 30, 1949 figures).* Divestment of the gas properties of Jersey Central was ordered, on the basis of an uncontested Division position, in *General Public Util. Corp.*, 32 S.E.C. 807, 814-15 (1951). The claimed $229,398 loss of economies included no adjustments to reflect the advent of natural gas, a favorable development that was "virtually assured. As a consequence," the Commission said, "the severance study has little, if any, probative value for the purposes of this proceeding. Without the determination of the result of the introduction of straight natural gas in all three divisions upon the operations of the gas department, the increase in expenses brought about by severance cannot be evaluated". 32 S.E.C. at 836-37.

5. *Louisiana Power & Light Company (1954 figures).* The gas properties of Louisiana Power & Light were ordered divested in *Middle South Util., Inc.*, 35 S.E.C. 1 (1953). The Appendix to the Commission's Findings and Opinion in the present case cites figures for the year 1954 which obviously cannot have been the basis for a 1953 divestiture order. The Commission did not rely on figures for 1954 or any other year. The situation was just the opposite. There were no figures. "No study of any kind was introduced to show what the expense of the gas properties would be if they were operated as a separate unit". 35 S.E.C. at 12.[2]

The remaining two precedents do not support the decision but may have some relevance. They are:

1. *Philadelphia Company (1946 figures).* Divestment of Philadelphia's gas properties was ordered in *Phila-*

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[2] Two years later, in 1955, the Commission declined to reopen the case, again without reference to any figures. Middle South Util., Inc., 36 S.E.C. 383 (1955).

*delphia Co.*, 28 S.E.C. 35 (1948). This opinion perhaps represents a relevant administrative decision as the Commission stated that even on the basis of the company's figures, the loss of economies would not be substantial. 28 S.E.C. at 52-53. However, over the next twenty pages of the opinion, the Commission enumerated the defects in the evidence. Respondents understand the substance of the decision to be that the Commission did not believe the amount of the claimed losses, as shown by its extensive treatment of the evidence. Nonetheless the opinion is somewhat ambiguous, and it is difficult to say exactly what the holding is.

2. *Northern Pennsylvania Power Company (June 30, 1949 figures).* Divestment of the electric properties of North Penn was ordered in *General Public Util. Corp.*, 32 S.E.C. 807 (1951). GPU had conceded the Commission staff's position that the electric properties could not be retained, but the Commission reviewed the staff's position and wrote a lengthy opinion.[3] It held that the evidence submitted as to estimated losses would not affect its conclusion in a prior proceeding as to the ability of North Penn to operate economically as a separate entity. 32 S.E.C. at 832. Accordingly, Respondents conclude that the Commission's holding with respect to the insufficiency of the estimated losses, even though uncontested and related to an electric company, may represent a relevant administrative decision.

[3] 32 S.E.C. at 814-15. The Commission's careful treatment of the uncontested issues in this aspect of the case and the part of the case involving the Jersey Central gas companies noted above is in marked contrast to its handling of the Section 2(a)(29)(B) issue in the instant case.

Thus the Commission's Appendix (A. 28) includes no more than two cases in which divestment may have been ordered "on the ground that the estimated loss of economies was not substantial within the meaning of Clause A." (A. 16). In one case the holding was alternative; in the other, the issue was conceded. The ratios for the NEES gas companies, based on figures as adjusted by the Commission, exceed the comparable ratios in the highest of these two precedents (for what relevance they may have) by percentages ranging from a low of 59% to a high of 342%.

No. 305

# In the Supreme Court of the United States

OCTOBER TERM, 1967

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SECURITIES AND EXCHANGE COMMISSION, PETITIONER

*v.*

NEW ENGLAND ELECTRIC SYSTEM, ET AL.

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*ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT*

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## REPLY BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

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## CITATIONS

# In the Supreme Court of the United States

October Term, 1967

No. 305

Securities and Exchange Commission, petitioner

*v.*

New England Electric System, et al.

*ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT*

**REPLY BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION**

The basic issue respondents tender is whether the Commission properly exercised its expertise in ruling that NEES had not established that the divestiture of its gas system would result in the "loss of substantial economies" under Section 11(b)(1)(A) of the Public Utility Holding Company Act of 1935. Respondents specifically accept (Br. 12) the major premises of our opening brief: that retention of an additional system represents "a narrow exception to the general policy of the Act" limiting registered holding companies to a single integrated system; that the holding company has the burden of affirmatively bringing itself within this exception; and that this burden is a heavy one, since the test for determining whether there will be

a "substantial" loss of economies upon divestiture is "stringent." They contend (*ibid.*), however, that the Commission must "apply its expertise specifically to analysis and prediction of the *effect* of anticipated loss on the future health and operation of the divested system" (italics in original), and that the agency failed to do so in this case. More specifically, their major contentions are (1) that the Ebasco study showed that divestiture would result in an annual loss of economies in excess of $1,000,000, and that the Commission neither had adequate grounds nor adequately explained its reasons for refusing to accept this figure (Point 1, Br. 13–24); (2) that such a loss is "substantial" in the statutory sense (Point 2, Br. 24–30); and (3) that in applying the test of "loss of substantial economies" approved by this Court when the case was previously here—"economies so important as to cause a serious impairment of [the] system" (384 U.S. at 179)—the Commission cannot give any weight to the advantages of competition without "identifying and evaluating specific benefits" by way of a "set-off against proven loss" (Point 3, Br. 30–33, quoted language at p. 32).

Although our opening brief demonstrated that the Commission's decision in this case represented a sound application of the Commission's experience and skill gained through many years of administering the statute, respondents' contentions require a somewhat fuller discussion of the agency's decision and the record upon which it was based.

# I

## THE COMMISSION WAS JUSTIFIED IN CONCLUDING THAT THE EBASCO REPORT DID NOT ESTABLISH THAT DIVESTITURE WOULD ENTAIL THE LOSS OF SUBSTANTIAL ECONOMIES

### A. THE COMMISSION WAS QUALIFIED TO EVALUATE THE RELIABILITY OF THE EBASCO STUDY AS A BASIS FOR PREDICTING THE ADDITIONAL EXPENSES LIKELY TO BE INCURRED UPON DIVESTITURE

Basic to respondents' arguments is the apparent assumption that the Ebasco firm, which had devoted more than 4,500 man hours over a period of twelve months with the cooperation of NEES officers and employees to a forecast of the effects of severance, was so expert and was capable of such precision in forecasting the numerous business decisions that would confront the post-severance management (see our main brief, pages 19–21) that the Commission could reject the sum of the individual predictions only to the extent of demonstrable and measurable errors, such as arithmetical mistakes in adding up the individual items.

We pointed out in our main brief both the inherent uncertainties of such a forecast (pp. 19–21) and the internal inconsistencies in the Ebasco study that undermined its reliability as an accurate prediction of future cost increases (pp. 22–27). Over the years the Commission has considered a number of similar studies and predictions of holding company managements and their outside experts in determining the retainability under Clause A of other utility systems as to which a claim of "loss of substantial economies" was made; it accordingly was able to evaluate the over-

all reliability of the Ebasco study as a reasonable prediction of the additional expenses likely to result from divestiture. It would be both impractical and unnecessary to require the Commission to determine whether each of the innumerable assumed post-severance business decisions would be made and, if so, would have the consequences predicted. The Commission thus had ample basis for concluding that the defects it found in the Ebasco study "materially impair[ed] its persuasiveness and ma[de] it unacceptable" (A. 24) as an accurate forecast of additional costs upon divestiture—a conclusion reinforced by its observation of successful operation of other systems that are smaller or no larger than the NEES gas system (A. 17–18, *infra*, pp. 12–22).

Respondents argue (Br. 11, 14–15), however, that the Commission does give weight to similar forecasts and, indeed, must have relied upon the Ebasco study in this case in finding that the NEES gas companies constitute an integrated gas system. They point out that Section 2(a)(29)(B) lists, as one element in the definition of such a system, that "substantial economies may be effectuated" if the companies are "operated as a single coordinated system," and urge (Br. 16) that the Commission "had no other basis for concluding that the NEES gas companies are a single integrated system, and it conceded that point (A. 3)." There was no concession, however, of the reliability of the Ebasco report for any purpose. The staff had conceded that the NEES gas system constitutes a single integrated system and the Commission's express reliance was on that concession (A. 3). If the Com-

mission in fact relied on the Ebasco report in accepting that concession, it was only because the report showed that treating the gas companies as a single system was consistent with the economic philosophy of the Act. Each of the gas companies was relatively small; the companies operated in a compact area in a single state; and there were no overlapping service areas. In that context the evidence concerning the advantages of operating the companies under common officers and professional employees and of jointly purchasing fuel oil to produce gas for peak demands, provided a justification for keeping the gas companies together that had no counterpart in respondents' case for retaining both the gas and electric systems.

As indicated in our main brief, the Commission rejected the Ebasco estimate for purposes of applying the test of retainability under Clause A in part because it did not make out a convincing case for exception to the general policy of the Act that ordinarily holding companies would be limited to a single system—a conclusion confirmed by the inherent incredibility of the claim that a system as large as the NEES gas properties could not operate efficiently on its own. Insofar as the rejection rested upon internal inconsistencies, these appeared to suggest that, in changing the basis of the study from divestment of the eight gas companies separately to divestment as a system, the adjustment made inadequate allowance for savings from operation as a system (see our main brief, p. 22–23, and *infra*, p. 6–12).

B. THE COMMISSION WAS JUSTIFIED IN CONCLUDING THAT THE DEFECTS IN THE EBASCO STUDY MADE IT UNRELIABLE AS A BASIS FOR ESTIMATING THE INCREASED EXPENSES UPON DIVESTITURE

1. Respondents challenge (Br. 14) the statement in our main brief (pp. 22–23) that the Ebasco study had originally been prepared to show the loss of economies to each gas company, if each were to operate independently after severance, and then had been readjusted to allow for the hypothesis that the gas system would be divested as a unit. Mr. Quig, who was in charge of the Ebasco study (R. 101), testified that Ebasco's "original gas severance study was developed on the assumption that the eight gas companies would go out of the NEES system individually and be operated independently of one another" (R. 564). When NEES later decided to consider the possibility of combined gas operations separate from the electric system, the results were set forth, Quig testified, in a "Supplemental Report" (R. 563, 565). He further explained that "[s]ince an analysis of the loss of economies on a combined basis requires much of the ground work which is set forth in the study on an independent company basis, it seemed to us to make more sense to follow the independent company basis through to its conclusion and then look at the combined basis" (R. 573).[1]

[1] The letter from Ebasco to NEES transmitting the Supplemental Study and the Introduction to the Supplemental Study both confirm that it was prepared separately and that Ebasco considered "[m]uch of the work done and the data collected in the course of the [original] study" to be applicable, with appropriate adjustments, to the Supplemental Study (Respondents' Exhibit 91, R. Vol. VI, pp. 1–2).

2. Respondents seem to suggest (Br. 17–20) that two separate and insignificant criticisms form the basis for the Commission's rejection of the Ebasco conclusions. Respondents misconstrue the Commission's decision. These two factors, along with others, together provide examples of significant deficiencies in computing increased costs of customer accounting—a major component of the Ebasco estimates. The Commission noted that customer accounting alone, one aspect of treasury cost, represented 40 percent of the projected total increased cost resulting from severance of the gas properties (A. 12). If that $415,600 figure for customer accounting was substantially in error, it necessarily affected Ebasco's overall conclusion of the estimated loss of economies. The Commission noted that an identical amount was estimated for customer accounting both in the original study, which assumed separate operations of the gas companies after severance, and in the supplemental report, which purported to project the results of combined operations (R. Vol. VI p. 40) and that Ebasco had failed "adequately to explain why combined operations would not result in lesser amounts for such costs * * *" (A. 12).

3. It is not disputed that the Ebasco Supplemental Study made no adjustment to the earlier study (which assumed each gas company would be separately operated) to reflect any potential saving from centralized billing for the NEES gas system after divestment. To the Commission it appeared that unnecessary additional personnel would thus be employed for billing purposes and that respondents had given no

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satisfactory explanation why some form of combined billing procedure could not be employed advantageously (A. 12–13).

Respondents argue (Br. 17–19) that, contrary to the Commission's findings, the Ebasco experts considered and for sound reasons rejected centralized billing and that, in any event, customers' billing was not a "significant part of a broader function called customer accounting * * *" (Br. 18). But Johnson, the witness who was responsible for the treasury and accounting elements of the Ebasco report (R. 522), admitted that no study of the matter had been made (R. 898, 901, 908), although he acknowledged that in the utilities industry "centralized billing is, perhaps, predominant, more than predominant" (R. 911). And while he claimed competence to testify that there would be no savings, he conceded that without further study he would not so advise the severed gas system as a hypothetical future client.[2]

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[2] "XQ. Mr. Johnson, assuming that the combined companies were separated from the NEES System, and were to request—were to ask, rather, for your opinion, as to whether or not they should install a centralized billing arrangement, what would your answer be?

"A. I would not give them a definitive answer until I made a study, in sufficient depth to give them a sound recommendation.

"XQ. How can you give us an opinion then?

"A. That is a different case. Here, I say, in my judgment, these decentralized billing centers will not result in any substantial increased cost, and you will not make any substantial savings by doing it on a centralized basis.

"XQ. Is that the answer you would give the Management?

"A. I told you I would make a study in sufficient depth." (R. 913)

Respondents' quotation from the court below as to the extent of the savings from centralized billing, as compared to overall costs (Br. 18–19), shows that the court misapprehended the purpose and significance of the Commission's conclusions with respect to centralized billing. The Commission did no more than to conclude from Ebasco's failure to consider this matter in sufficient depth and from other unexplained anomalies in the report that the deficiencies "substantially impair the credibility and preclude the acceptance of * * * [Ebasco's] estimate of a $472,100 increase in treasury and accounting costs and, in turn, of its over-all estimate of increased costs (of which that figure is a material part) * * *" (A. 14). Thus, even if the dollar amount of Ebasco's prediction of increased billing costs is itself not deemed sizable, as respondents suggest (Br. 19), the analytical error it involves disclosed a fundamental weakness in the methodology of the study and, in conjunction with the other deficiencies noted by the Commission, justified the latter in rejecting the study.

4. Ebasco's computations showed the difference between the expense per books and the expenses it estimated *pro forma*. These differences, which purported to reflect the increases in expenses resulting from severance are valid, of course, only if both the book figures and the manner of deriving the *pro forma* estimates are correct. To test these figures, the Commission selected two localities—Lynn and Northampton—in which both gas and electric services were provided and certain elements of treasury and accounting work were jointly performed by the two subsidiaries.

With respect to Northampton, the Commission found that an allocation had been made by NEES between its gas and electric subsidiaries which attributed a significantly greater share of the joint customer accounting expense, computed on a per-customer basis, to the electric company (A. 13). With respect to the broader category of "treasury and accounting," the Commission found a similar anomaly in the allocation of expenses between the gas and electric companies located in Lynn (A. 14). In the absence of an adequate explanation, as the Commission observed, these facts cast doubt upon the estimates of increases both in customer accounting and in the larger category of "treasury and accounting." Since the allocation of expenses to the gas operations apparently was understated in each case, an overstatement of post-severance projected increases in expenses predicated upon those figures would necessarily result. Respondents suggest (Br. 20) that the Commission comparisons are "meaningless" and that an explanation exists for these apparent inconsistencies; but the Commission was entitled to rely upon what the record showed, and respondents tacitly admit that they never attempted to explain this anomaly in the figures upon which the Ebasco study was predicated.[3]

Respondents also assert that, with respect to its analysis of joint accounting in Northampton, the

[3] Respondents state that their witness "was cut off on this point by counsel for the Commission's staff" and that counsel never thereafter returned to the subject (Br. 20), but this omission to continue a particular line of cross-examination in no way remedies respondents' failure to sustain its burden of proof.

Commission erred in its use of *pro forma* figures on an independent rather than on a combined gas company basis (Br. 20). With respect to Northampton, however, the Commission focused its attention specifically on the allocation of customer accounting expenses, and the record shows that *pro forma* estimates for customer accounting at Northampton were identical—as indeed was the $415,600 projected customer accounting cost for all gas companies combined—whether projected on an independent or a combined basis. (Compare R. Vol. VI p. 32 with R. Vol. IV p. 620; cf. R. Vol. VI p. 40.)[4]

5. Respondents dispute (Br. 17 n. 8) a statement in our brief quoting from the opinion of the court

[4] In the pages of the record cited by respondents (R. Vol. IV p. 626), certain adjustments had been made to the customer accounting estimates on an independent basis. Since those adjustments would be equally appropriate whether separate or combined operation was assumed, the Commission was entitled to employ the adjusted amount for purposes of its analysis (See A. 13).

The Commission's observations (A. 13–14) concerning the allocations made on the books with respect to the customer accounting expenses for Northampton and the treasury and accounting expenses for Lynn are unaffected by the fact that the Commission, in pointing to the unaccountably greater percentage increase in the treasury and accounting expenses projected for the gas companies than for the electric companies, referred to the *pro forma* figures on an independent, rather than on a combined, basis; in either case the prima facie inappropriateness of the per book figures was clearly demonstrated. Furthermore, whether the combined or independent *pro forma* projections are employed for those companies, a substantially greater percentage increase is attributed by the Ebasco report to the gas companies than to the electric companies in the significant item of treasury and accounting expense, and the existence of any such disparity tends to support the Commission's conclusions.

below that the Commission found suspect "the estimated additional salaries and/or positions for the top executive staff" of the post-severance gas system; they contend that there is no support for that statement in the Commission's findings and opinion. The Commission's views of this point are developed in its review of the details of the proposed salary costs and comparions with existing positions and salaries of the gas division, which indicated that persons holding comparable responsibilities to present officials would receive substantially larger compensation (A. 15 n. 19).

C. THE UNRELIABILITY OF THE EBASCO CONCLUSION IS CONFIRMED BY THE FACT THAT INDEPENDENT MASSACHUSETTS GAS COMPANIES COMPARABLE TO THE NEES GAS SYSTEM WERE ABLE TO OPERATE SUCESSFULLY.

In addition to the internal inconsistencies and flaws that made the Ebasco report unreliable as an accurate prediction of the additional expenses likely to result from divestiture, there was another fact that raised serious doubt as to its soundness. Taking the Ebasco figure of $1,098,600 loss of economies, without any allowance for inherent uncertainties or for offsetting benefits of competition, the court below derived a return on rate base for the severed NEES gas system of only 4.1 percent (A. 57–58).[5] Although the claimed

[5] The Commission's staff did not have convenient access to rate-of-return figures for the NEES subsidiaries and the only sense in which they "adduced evidence" was by questioning respondents' witnesses. Apparently the court below was referring to the figures on respondents' Exhibit 114 (R. 1431), which was introduced at the request of the staff. This exhibit showed an aggregate rate base for the year 1959 of $47,723,162 and "net

economies were attributable primarily to the separation of gas and electric properties serving common customers, there was no attempt by NEES to show from actual experience that any sizable independent gas company in the area was unable to operate efficiently and earn a fair return on its rate base. On the contrary, the record showed that seven comparable gas companies in Massachusetts not operating under common control with electric companies serving the same area were earning approximately 6 percent on their rate base (*infra*, pp. 18–19).

The fact of such successful operation of these other companies further confirmed the Commission's conclusion that the Ebasco study seriously overstated the additional expenses that would be incurred on divestiture. For if other comparable Massachusetts gas companies could operate successfully and produce a fair rate of return without the alleged benefits resulting from the combination of electric and gas properties

operating income" of \$3,050,988, from which respondents computed a 6.4 percent rate of return. Deducting the \$1,098,600 of forecast additional expenses from the \$3,050,988 figure gives \$1,952,388, which is approximately 4.1 percent of \$47,723,162. But if NEES were to incur such additional expenses, there would be income tax deductions of roughly 50 percent, so that the actual reduction in the projected rate of return for the NEES gas system would be only half as much as assumed by the court below. The rate of return would be about 5.2 percent.

This error might also account for the concern of the court below as to the possibility of "new equity financing" (A. 59), despite the testimony of Mr. Hanson, the chief financing and accounting officer of the NEES system (R. 333), that he "would expect" that the severed gas system would be able to arrange financing "on a sound and economic basis," although probably its equity financing would be more costly than at present (R. 1159–1160).

serving largely the same customers, it is difficult to see why the NEES gas system could not also do so.

Indeed, the experience of the independent companies suggests (1) that the Ebasco report overstated the increased expenses; (2) that the severed NEES gas system would not be operated as efficiently as the independent gas companies; or (3) that the advantages of freeing a gas system from common control with a competing electric system, although not reducible to figures, are more significant than either NEES or the court of appeals recognizes. But whichever of these hypotheses may be correct, NEES plainly had not sustained its "heavy burden" (see Resp. Br. 12) of showing that divestiture of its gas system would entail the "loss of substantial economies" under Clause A.[6]

[6] Respondents' argument and the reasoning of the court below assumed that there is a sharp differentiation between the issue of the reliability of the Ebasco forecast and the issue of the substantiality of the loss of economies if such reliability be accepted. While the Commission's opinion dealt sucessively with these two elements of NEES's case, the ultimate issue was whether NEES had met its burden of showing a loss of substantial economies within the meaning of Cause A. The Commission referred to the successful operation of the independent gas companies in that portion of its opinion dealing with the failure of NEES to establish that any loss of economies "would be substantial", even accepting the Ebasco forecast. We have pointed out (Main Br. pp. 27–28) that implicit in that treatment is recognition of inherent uncertainties of such a forecast. Once this inherent uncertainty is recognized, it becomes apparent that the experience of the independent companies is pertinent to both aspects of the case as well as to the overall conclusion of the Commission that NEES had not satisfied its burden under Clause A.

D. THE COMMISSION PROPERLY TREATED THE SEVEN OTHER GAS COMPANIES IN MASSACHUSETTS AS COMPARABLE TO THE NEES GAS SYSTEM

The inferences that the Commission drew from the apparently successful operation of other Massachusetts gas companies must be evaluated in relation to the nature of the loss of economies claimed by NEES. NEES's president, William Webster, testified: "The supplemental study establishes that almost 80 percent of the total loss of economies stems from the separation of gas from electric" (R. 755–756). Webster was referring, of course, to the fact that the NEES gas and electric companies have overlapping service areas and common customers. About 78 percent of the NEES system's gas customers were also served by its electric subsidiaries (A. 4).[7] The Commission's finding that respondents here attack was that other "independent" Massachusetts gas utility companies, although subject to the same competitive conditions applicable to the post-severance NEES gas system, "nevertheless have been able to conduct their operations and, apparently, earn a fair return without the alleged advantages of common control with electric utilities by a holding company." (A. 17.) Respondents argue (Br. 28) that the "Commission assumed with

[7] In our main brief (p. 22 and n. 7), we used the figure of "more than 70 percent" in pointing out the anomaly of respondents' attribution of approximately $1,100,000 of predicted losses to separation of the gas and electric systems and only approximately $400,000 to the further fragmentation of the gas system into eight smaller units. Regardless of figures, it is clear that the alleged advantages of combining electric and gas service in the same area are the heart of NEES's case for loss of economies from severance.

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no evidence, that the other companies in Massachusetts used for comparison (i) were independent, (ii) were subject to the same competitive conditions, (iii) were able to compete effectively with oil and (iv) were capable of economical operation" and that there is "clear and explicit evidence controverting each" of these assumptions.

Respondent's Exhibit 117 (R. 1436, 1227), offered at the request of the Commission's staff, is the basic document upon which the Commission based its conclusion that other comparable Massachusetts gas companies had been able to operate successfully without being under common control with an electric company serving the same customers. But in view of the respondents' attack on the validity of the Commission's comparison, it is necessary to set forth in some detail the background against which this exhibit was introduced.

The Chairman of the Massachusetts Department of Public Utilities had testified that an unnamed Massachusetts gas company had gone bankrupt. This statement, to which respondents twice refer (Br. 28, 35), was made in the following context (R. 591):

> Q. But it is true, is it not, Mr. Lang, that there are gas companies which are operating successfully in your area without being part of a system such as NEES?
>
> A. Of course that is true—although the word "successful" is a relative matter. The point is that each of these gas companies has its own particular background and history, its own problems as to franchise areas, expenses, and its own standards as to service.

> Taking into consideration the problems and situations in which they have developed over the years, these eight gas companies today generally operate on a sound efficient basis under our supervision and regulation. But, we do have ecenomic [sic] problems with some gas companies, as might be expected in this area of intense competition with which the gas companies are faced.
>
> One of our gas companies in the Connecticut Valley has recently been through bankruptcy. It has since been converted to natural gas and taken over by another gas company in the western part of the Commonwealth.
>
> In other cases it is obvious that some of the independent companies suffer from not having the economies of being part of a system such as the NEES system.

The following day Webster, the president of NEES, attempted to treat this reference to the misfortune of an apparently small manufactured-gas company, the identity of which was never revealed, into a significant indication of prospective difficulties for the large NEES natural gas system following divestment. His pertinent testimony is as follows (R. 762):

> XQ. Well, now, how are these independent non-affiliated gas companies able to operate apparently profitably and efficiently, without the advantage of a holding company?
>
> A. Well, first, some of them have gone bankrupt, as the Chairman of the Massachusetts Department of Public Utilities testified yesterday. Others are—it wouldn't be fair to say just a jump ahead of the sheriff, but they are unable to give the service we think we give,

and they are probably closer to the line. They face a more serious competitive position than ours do operated as we are now handling it.

XQ. Are any of the larger gas companies, independent gas companies, in Massachusetts, experiencing difficulty with rendering adequate service, and financing themselves, that you know of?

A. I am not in a position to answer that.

In view of Webster's lack of knowledge as to how the sizable independent Massachusetts companies were faring, NEES was requested to, and did, supply from the public record of reports to the Massachusetts Department of Utilities figures as to the return on rate base for the seven companies listed on respondents' Exhibit No. 117.[8] The following table combines some of the information on that exhibit and on respondents' Exhibit 90 to show, for the years 1958 and 1959 the rates of return on rate base and

[8] Respondents criticize the selection of these seven companies (Br. 28–29, n. 17). As they note, one of the Ebasco witnesses, for a different comparative purpose, had referred to twelve non-affiliated Massachusetts companies. His worksheet became respondents' Exhibit 90, which purported to include every gas company in Massachusetts, including gas departments of combined gas and electric companies, with more than 5,000 gas meters (R. 557–562, 1365). The staff eliminated five of these twelve companies as not comparable to the severed NEES gas system—three of them because they were combined gas and electric companies; a fourth, Boston Gas Company, because it had not, as of the year in question, converted to natural gas; and, finally, Buzzards Bay Gas Company (which barely exceeded the minimum of 5,000 meters used by the NEES expert as a test of comparability) because of its seasonal business (notes to Division's Exs. 4A—4D, R.1449–1452).

for the year 1958 the number of customers served by each of the seven companies:

| | No. of Customers, 12/31/58 | Rate of Return on Rate Base | |
|---|---|---|---|
| | | *1958* | *1959* |
| Berkshire Gas | 24,963 | 6.0% | 5.2% |
| Brockton-Taunton Gas | 51,955 | 6.2 | 6.1 |
| Fall River Gas | 34,576 | 6.4 | 6.2 |
| Haverhill Gas | 19,786 | 6.4 | 6.8 |
| Lowell Gas | 29,206 | 8.5 | 7.9 |
| Springfield Gas | 66,179 | 6.5 | 6.4 |
| Worcester Gas | 77,940 | 5.4 | 4.5 |
| Average | ---------- | 6.3% | 5.9% |

Although respondents contend (Br. 29, n. 17) that only three of the seven companies on Exhibit 117 are "independent," they neither explain what they mean thereby nor specify the companies to which they refer. The Commission used the term as meaning companies not under common control with an electric company serving the same area—a sound basis for comparing the performance of the other gas companies in view of the fact that nearly 80 percent of the alleged increased expenses upon divestiture projected in the Ebasco study resulted from the separation of the overlapping NEES gas and electric companies.

Each of the gas companies shown on the exhibit is much smaller than the combined NEES system with its 235,765 customers in 1958 (Respondents' Exhibit 90, R. 1365). Their rates of return on rate base ranged from 5.4 to 8.5 percent in 1958 and 4.5 to 7.9 percent in 1959. Three of the companies—Berkshire Gas, Fall River Gas, and Haverhill Gas—apparently are concededly independent in an absolute sense, *i.e.,* they are

not under joint control with any other gas or electric company.[9] Brockton-Taunton Gas and Springfield Gas, serving, respectively, 51,955 and 66,179 customers, in the aggregate approximately half the number served by the NEES gas system, are affiliated with each other in the sense that they appear to be under common control but there is no affiliation with companies which supply electricity in their service areas. Worcester Gas Company is part of an exempt intrastate holding company system that has both gas and electric companies in Massachusetts, but it has no affiliation with a company furnishing electricity in the Worcester service area, where electricity is furnished by a NEES subsidiary (see respondents' Exhibit 3, R. 1297).[10] Lowell Gas Company apparently is under common control with Buzzard's Bay Gas Company, a small gas company[11] whose business is largely seasonal, but has no affiliation with any electric company.

Thus, each of the other seven gas companies considered by the Commission was comparable to the post-

[9] The primary authority respondents cite for their claim that the seven companies are not "independent" is Moody's *Public Utility Manual* (1959). The material in the text dealing with the affiliation of those compaines is derived from that source. In the court of appeals, where respondents made a simialr contention, they apparently conceded that Berkshire, Fall River and Haverhill were "independent" under any standard.

[10] These two companies also are under common control with Fitchburg Gas and Electric Light Company, and other companies outside Massachusetts. Adding the 10,967 customers from the gas department of the Fitchburg Company to those of Brockton-Taunton Gas Company and Springfield Gas Company still gives only 129,101 customers compared to 235,765 for the NEES gas system.

[11] Buzzards Bay served only 5,454 customers, compared to 29,206 served by Lowell, Respondents' Ex. 90, R. 1365.

severance independent NEES gas system since, in addition to operating in Massachusetts and being smaller than the NEES gas system, none was affiliated with an electric company serving the same customers. The Commission also properly rejected the further argument that these companies are not comparable because the NEES gas companies had peculiar handicaps in the service areas where they operate,[12] ruling that respondents had "failed to show that, because of these factors, the impact of severance would be such that the combined NEES gas operations * * * would be unable to compete effectively with oil, even though the nonaffiliated companies are able to do so" (A. 17–18, footnote omitted).

To be sure, the record contains no detailed study of the operations of these seven companies. But that fact does not vitiate the Commission's comparison between them and the divested NEES gas system. For, as noted, these companies were significantly smaller than the NEES system,[13] and *prima facie* their ability to operate successfully without being under common control with an electric company serving the same area was shown by Respondent's Exhibit 117 and confirmed

[12] These handicaps were the relatively slower economic growth, population increase and suburban development increase for the NEES gas franchise areas compared to those of the independent gas companies.

[13] The New England Gas and Electric Association, an intrastate holding company of which Worcester Gas Company is a part, had slightly higher consolidated gas revenues than the NEES gas system ($23,358,000 as against $23,276,000) but significantly fewer gas customers (approximately 171,000 as compared to 235,765) (Respondents' Exhibits 57 (R. 1310); 90 (R. 1365)).

by the admission of NEES' president that he had no information to the contrary (*supra*, p. 18).

E. IN HOLDING THAT THE ADDITIONAL EXPENSES OF $1,098,600 ESTIMATED BY THE EBASCO REPORT WOULD NOT CONSTITUTE A LOSS OF SUBSTANTIAL ECONOMIES, THE COMMISSION PROPERLY CONSIDERED ITS DECISIONS IN PRIOR DIVESTMENT CASES.

In ruling that, even accepting *arguendo* the Ebasco estimate of a $1,098,600 loss of economies upon divestiture, such loss would not be substantial, the Commission examined the impact of such increased expenses upon the NEES gas system, as measured by ratios it deemed significant; [14] and pointed out that such ratios "are lower or not significantly higher than corresponding ratios of gas systems whose divestment we have required on the ground that the estimated loss of economies was not substantial within the meaning of Clause A" (A. 16).[15] It also noted (A. 19–21) that in such prior cases it had recognized that there were offsetting advantages resulting from the termination of joint control of electric and gas systems serving the same locality, which must be considered in determining the substantiality of the claimed losses of economies.

Respondents challenge (Br. 24–27) this comparison with the prior divestments on two grounds: (1) that it is irrelevant, since it allegedly tells nothing about

[14] The ratios were between the additional estimated expenses of the NEES gas system and its operating revenues, operating revenue deductions and gross and net income before federal taxes.

[15] Attached to its opinion is a table (A. 28) comparing the estimated NEES loss of economies "with the estimated losses in the [seven] prior cases where similar computations were made, in all of which we ordered divestment of the additional system" (A. 16, n. 22).

what the effect of the additional $1,098,600 expenses would be upon the ability of the NEES system to operate successfully; and (2) that it is inaccurate, since in five of the seven cases the Commission's divestment orders "were based not on a finding that the claimed loss of economies was not substantial, but on the fact that the Commission had not believed the estimates or that the estimates failed to show the amount of lost economies" (Br. 27).[16] Neither contention is valid.

1. Of course, the basic question before the Commission was what would be the probable effect of the additional expenses upon the ability of the NEES gas system to operate successfully, *i.e.,* would the lost economies be "so important as to cause a serious impairment of that system" (384 U.S. at 179). But in answering that question the Commission was not required to limit its inquiry solely to the NEES system; the fact that comparable increases in additional expenses had not been deemed "substantial" in other divestment cases provided considerable support for the Commission's conclusion that they were not substantial for NEES, either. In applying a legal standard that is essentially relative rather than absolute—such as whether an alleged loss of economies would be "substantial"—its application in other situations is certainly a useful guide to its content.

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[16] The Commission also relied on its prior decisions to show that the NEES gas system was larger than any other it previously had ordered divested (A. 18, n. 24). Respondents do not challenge the use of the comparison for that purpose.

2. In the appendix we discuss in some detail the five prior Commission cases with respect to which the respondents accuse the Commission of incorrectly stating the amount of additional expenses it deemed not substantial. In three of those cases the Commission accepted *arguendo* the claimed loss of economies (with certain adjustments the Commission took account of in the present case), but pointed out (as it did in the present case) that they must be evaluated in light of the offsetting benefits resulting from divestiture before their substantiality could be determined. In another of the cases respondents do not describe accurately the Commission's opinion. In the fifth case, the claim is that the figures relied on by the Commission were for the year after it rendered its decision; those figures, however, were taken from a petition for reconsideration which, the Commission held, provided no basis for disturbing its prior ruling that no loss of substantial economies had been shown.

In short, the figures upon which the Commission based its comparison between the impact of divestiture on the NEES gas system and upon the other gas systems held not retainable were accurate, and provided a proper basis for making the comparison.

## II

### IN APPLYING SECTION 11(B)(1)(A), THE COMMISSION PROPERLY GAVE SIGNIFICANT WEIGHT TO THE COUNTERVAILING BENEFITS OF COMPETITION

Respondents' arguments on this point are little more than a paraphrase of the view of the court below that the intangible benefits of competition result-

ing from the termination of common control of electric and gas properties are to be considered only for the purpose of adopting a "stringent" standard of retainability, but not at all in applying that standard. But if, as this Court previously held (384 U.S. at 182–185), such offsetting benefits are an appropriate factor in determining the meaning of "loss of substantial economies," they also may be considered by the Commission in applying that concept. For only in this way can this element become a truly meaningful part of the statutory standard.

Indeed, this Court appears to have specifically so recognized, since it pointed out that the determination whether "gains to competition * * * might well offset the estimated loss in economies of operation resulting from a separation of the gas properties from the utility system * * * is a matter for Commission *expertise* on the total competitive situation * * *" (pp. 184–185, footnote omitted). As pointed out in our main brief, and as this Court recognized,[17] such competitive advantages cannot be forecast with precision. The court of appeals' view that such offsetting benefits may be considered in determining whether a projected loss of economies is "substantial" only if "some definable particularized benefit will accrue from divestment" (A. 61) would, as a practical matter, deprive this factor of the significance this Court recognized Congress intended it to have.

The instant case is a particularly strong one for giving weight to the advantages of competition in

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[17] The Court stated (p. 184): "Competitive advantages to be gained by a separation are difficult to forecast."

applying the standard of Clause (A). As noted above (p. 15), between 70 and 80 percent of the claimed loss of economies from severance were attributed by respondents to the alleged advantages of common control of gas and electric systems with overlapping service areas. Moreover, other comparable Massachusetts gas companies not subject to such common control generally earned a substantially higher return than that projected for the independent NEES gas system (*supra*, pp. 12, 19). The Commission was fully justified in rejecting respondents' contention that "a management solely interested in and devoted to the gas operations would not be able to advance them more effectively" (A. 21).

Respondents contend (Br. 32) that permitting the Commission thus to consider the intangible benefits of competition would immunize from judicial review every Commission determination that a loss of substantial economies had not been shown. The argument is that the agency always could rely on this factor as outweighing any demonstrated losses, no matter how large they might be. But such a hypothetical situation is a far cry from this case. For here, as we have shown, respondents have not established any losses that are "substantial" in the statutory sense; and to the extent that the case on this issue may be closer than we have argued, the offsetting competitive benefits were more than sufficient to tip the scales against retainability of the gas system.

# III

## THERE IS NO OCCASION TO REMAND THE CASE TO THE COMMISSION

The arguments presented in our main brief and in this reply brief demonstrate that the Commission was justified in ordering divestiture of the NEES gas system because respondents failed to carry their burden of showing that such divestiture would entail the "loss of substantial economies." To recapitulate: the Commission properly (1) evaluated the claimed loss of economies from severance in the light of the congressional purpose to create a narrow exception in Clause A, for which it was expected that only small systems would qualify;[18] (2) weighed the offsetting advantages of competition in considering the claim that gas and electric companies serving the same area had certain advantages that would be lost upon severance; and (3) rejected a prophesy of loss of economies which is inconsistent with the actual experience of every sizable independent gas system in Massachusetts that operates on natural gas.

[18] Respondents argue (Br. 8) that in adverting to this expectation we are attempting "to reopen under Clause (A) the size requirement contained in Clause C (Br. 6, 31–33), as to which the Commission had specifically found that the requirement is satisfied (A. 7)." But the two clauses relate to different issues. Clause C requires the Commission to find that "[t]he continued combination of [of the principal and additional systems] * * * is not so large * * * as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation." It deals with the size of the two systems together, and the Commission found that the continued combination of the

There is no conflict in the expert testimony or disagreement among expert witnesses; the issue is whether the Commission had a reasonable basis for concluding that this expert evidence did not prove what it purported to demonstrate. This Court can decide that question, we believe, without further elucidation by the Commission or extensive analysis of the lengthy record. It should therefore reverse the judgment of the court of appeals and remand with instructions to that court to affirm the order of the Commission.

Respectfully submitted.

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JANUARY 1968.

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NEES electric and gas properties would satisfy that standard. Clause A, on the other hand, deals with the loss of economies by the additional system, and in applying that Clause the fact that the additional system is large is a significant factor. See our Main brief, pp. 31–33.

## APPENDIX

We discuss below the five precedents cited by the Commission, the use of which the respondents criticize in the appendix to their brief (Br. B-1–B-3). Respondents concede (Br. B-3–B-5) that the Commission properly relied upon the figures relating to the gas properties ordered divested in *Philadelphia Company,* 28 S.E.C. 35 (1948), affirmed, 177 F. 2d 720 (C.A.D.C.), and of the electric properties of Northern Pennsylvania Power Company ordered divested in *General Public Utilities Corporation,* 32 S.E.C. 807 (1951).

1. Respondents correctly point out (Br. B-2) that in ordering divestment of the gas properties of Virginia Electric and Power Company in *Engineers Public Service Co.,* 12 S.E.C. 41, 55–61, the Commission held that the company's estimate of \$71,500 loss of economies was "excessive" (12 S.E.C. at 59) and that "the record, if given its most liberal interpretation, would not sustain a finding of more than one-half the claimed increased *expenses*" (p. 60, emphasis is original, footnote omitted). But the Commission "further conclude[d] that the loss of *economies* would in fact be less than *such* increased *expenses* (emphasis added, footnote omitted) (*ibid.*). The reason for that conclusion, however, was not that there were further errors in calculating the amount of increased expenses, but because (*id.,* pp. 57–58)

> * * * Congress did not speak in terms of increased *expenses.* It authorized the retention of additional systems if they could not be operated independently without the loss of substantial *economies.* And in measuring the loss of *econ-*

> *omies* accompanying the severance of a combination of two utility systems it is particularly important to consider the beneficial effects of independent ownership upon the efficient operation of each system. [Emphasis in original.]

The Commission pointed out (pp. 57–58) that it was "particularly important to consider the beneficial effects of independent ownership upon the efficient operation of each system."

Thus, the Commission there accepted *arguendo* one-half of the claimed increased expenses—$35,750—for the purpose of evaluating the substantiality of the loss of economies, but concluded that, taking into account the offsetting benefits of divestiture, the lost economies would not be substantial. In the present case the Commission used the same figure it had accepted *arguendo* in *Engineers*—$35,750—for comparing the ratios in the two cases. The use of that figure plainly was proper.

2. In *Engineers Public Service* Co., *supra,* the Commission also ordered the divestiture of the gas system of Gulf States Utilities Co. 12 S.E.C. 78–81. There, too, the Commission, although stating that the estimated additional expenses were "in several respects overstated," ruled that "the total of these increased expenses to the gas system, stated to be $42,024, does not constitute lost economies arising from the independent operation of the gas system, since it ignores compensating factors" (p. 80). The Commission pointed out (p. 81) that it must "consider a possible failure to take advantage of all available economies in the gas operation," and noted that "competing gas and electric services under a single management may result in the suppression of one service in favor of the other."

3. In *North American Co.,* 18 S.E.C. 611 (1945), the Commission ordered the divestiture of St. Louis

County Gas Company. The Commission first reduced to $160,900 the holding company's estimate of additional expenses of $182,900, because of flaws in its calculation (pp. 614–615). It then ruled (p. 615) that "[t]o accept these estimates without further inquiry would be to distort the Act. * * * We are asked to permit electric and gas utility companies serving the same territory to be held together. The businesses, in many aspects of their operations, are competitors. It is the inevitable tendency of the joint control to favor that business in which it is most interested and which is most profitable. * * * Ultimately, the issue we must resolve is whether experience will bring about the increased costs claimed by respondents *without offsetting benefits*" (pp. 615, 617, emphasis added). Here, too, as in the two divestments ordered in *Engineers,* the Commission accepted *arguendo* the adjusted estimate of additional expenses, but found that it was not a proper measure of loss of economies because it failed to consider "offsetting benefits." Once again, this was the same situation as in the present case, and the Commission was justified in relying upon the comparison with the ratios in the *North American* case.

4. In the present case the Commission stated (A. 16, n. 22) that it had considered only certain of the ratios of the gas properties of Jersey Central Power and Light Co., ordered divested in *General Public Utilities Corp.,* 32 S.E.C. 807 (1951). The Commission in that case "accepted solely for the purpose of analysis, the amount of $229,398" additional expenses claimed by the company (p. 836), and used that figure in deriving the two ratios upon which the Commission relied in the present case (p. 837). The Commission held (pp. 836–837), however, that because the study did not reflect the impending introduction of natural gas throughout the company, it did not provide an ade-

quate basis for formulating the other ratios upon which the Commission had relied in previous cases in evaluating the substantiality of the claimed losses of economies. That the Commission did accept arguendo the company's estimate of $229,398 is further shown by the comparison the Commission made between ratios based on that figure and the ratios in the Virginia, Gulf States, St. Louis County Gas and Philadelphia Gas cases, *supra* (pp. 829, 836–837). Indeed, it utilized the same figures and ratios for those companies which it used in the present case. 32 S.E.C. 829.

5. In 1953 the Commission directed the divestment of the gas properties of Louisiana Power and Light Company in *Middle South Utilities, Inc.,* 35 S.E.C. 1. In rejecting the claim that such divestiture would entail the loss of substantial economies, the Commission pointed out (p. 12): "No study of any kind was introduced to show what the expense of the gas properties would be if they were to be operated as a single unit." It held (p. 13) that it could not "find that the mere statement by the witness for the company that there would be a substantial increase in the expenses of the gas operations if they were separated sustains the burden set forth in the statute."

Two years later the Louisiana Public Service Commission sought to reopen the divestment proceedings and filed with the Commission an offer of proof that divestiture would increase expenses of the gas properties by $272,816.[1] In declining to reopen, the Commission stated that it had "considered the offer of proof

[1] This figure is contained in the record before this Court in the *Louisiana* case. See record No. 466, October Term 1956, p. 17. The figure was given in the staff's brief before the Commission in the present case. S.E.C. File No. 59–102, Answering Brief and Proposed Findings and Conclusions of the Division of Corporation Finance, p. 33, n. 46.

made by the Louisiana Commission," but that the offer provided "no grounds for questioning our earlier conclusion." *Middle South Utilities, Inc.,* 36 S.E.C. 383, 385 (1955), reversed 235 F. 2d 167 (C.A. 5), reversed on other grounds, 353 U.S. 368. The Commission pointed out (*ibid.*) that it previously had held that "Louisiana Power could retain its gas operations only if they were so small that they could not operate economically under separate management, and we found that it was clear that Louisiana Power's gas properties are capable of effective and economical operation as a separate entity."

The Commission thus ruled that a showing of increased expenses of $272,816 would not persuade it to change its prior decision that divestiture would not cause the loss of substantial economies. It therefore in effect held that a loss of economies of that amount was not substantial. The Commission accordingly properly relied upon that figure in comparing the ratios in the present case with those in the Louisiana case.

U.S. GOVERNMENT PRINTING OFFICE: 1960

# SUPREME COURT OF THE UNITED STATES

No. 305.—October Term, 1967.

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| Securities and Exchange Commission, Petitioner, v. New England Electric System et al. | On Writ of Certiorari to the United States Court of Appeals for the First Circuit. |

[March 5, 1968.]

Mr. Justice Brennan delivered the opinion of the Court.

Respondent New England Electric System (NEES), a holding company registered under § 5 of the Public Utility Holding Company Act of 1935,[1] controls both an integrated electric utility system and an integrated gas utility system.[2] Section 11 (b) of the Act requires the Securities and Exchange Commission to limit the operations of a holding company system to a single integrated public utility system, except the Commission may permit the holding company to continue control of any additional integrated utility system that the Commission determines, among other things, "cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such

[1] 49 Stat. 812, 15 U. S. C. § 79e.

[2] At the time of this proceeding, the integrated electric utility system consisted of seven electric utility companies serving parts of New Hampshire, Massachusetts, Rhode Island, and Connecticut. The integrated gas utility system consisted of eight Massachusetts gas companies. NEES also controlled a service company which provided services for the whole NEES operation.

system . . . ."[3] In 1957 the Securities and Exchange Commission instituted proceedings to determine whether NEES should be permitted to retain control of both the electric and gas systems. The Commission initially found that the electric companies constituted a single integrated electric utility system, 38 S. E. C. 193 (1958), and NEES elected to retain those companies as its principal system. NEES urged, however, that it should also be permitted to retain the gas system. After extensive hearings, the Commission refused respondent permission to do so, and ordered the gas system divested. 41 S. E. C. 888 (1964).

In reaching its conclusion the Commission construed the statutory phrase "loss of substantial economies" in Clause A of § 11 (b)(1) to require a showing that the "additional system cannot be operated under separate ownership without the loss of economies so important as to cause a serious impairment of that system." In its first review of the Commission's order, the Court of Appeals for the First Circuit held that the Commission had

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[3] Section 11 (b) of the Public Utility Holding Company Act of 1935, 49 Stat. 820, 15 U. S. C. § 79k (b), provides in pertinent part: "It shall be the duty of the Commission, as soon as practicable after January 1, 1938:

"(1) to require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such action as the Commission shall find necessary to limit the operations of the holding-company system of which such company is a part to a single integrated public-utility system . . . : *Provided, however,* That the Commission shall permit a registered holding company to continue to control one or more additional integrated public-utility systems, if, after notice and opportunity for hearing, it finds that—

"(A) Each of such additional systems cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system . . . ."

erroneously construed the statute; in the court's view, "loss of substantial economies" merely "called for a business judgment of what would be a significant loss . . . ." The court therefore set aside the Commission's order and remanded for reconsideration in light of that test. 346 F. 2d 399, 406. We reversed, approving the Commission's construction, and remanded to the Court of Appeals for review of the challenged order in light of the proper meaning of the statutory term. *SEC* v. *New England Electric System*, 384 U. S. 176 (*NEES I*). On remand, the Court of Appeals again set aside the Commission's order. 376 F. 2d 107.[4] That court, "after a fresh review of all the evidence," concluded "that the Commission's opinion does not reveal that application of both reason and experience to facts which merits endorsement as the responsible exercise of expertise." *Id.*, at 111. We granted certiorari. 389 U. S. 816. We reverse and remand to the Court of Appeals with direction to enter a judgment affirming the Commission's order.

The question for our decision is whether the Court of Appeals properly held that, on the record, the Commission erred in finding that NEES failed to prove a case for retention of the integrated gas utility system. We address that question against the background of a congressional objective to protect consumer interests through the "elimination of 'restraint of free and independent competition.' . . . One of the evils that had resulted from control of utilities by holding companies was the retention in one system of both gas and electric properties and the favoring of one of these competing

[4] On remand, the Court of Appeals interpreted the "serious impairment" standard as requiring proof only of "a condition allowing survival but not on a sound or 'healthful continuing' basis," rather than proof that severance "will result in imminent bankruptcy . . . ." 376 F. 2d, at 109. The Commission has not contested this interpretation in this Court.

forms of energy over the other." *NEES I*, 384 U. S., at 183.[5] Congress therefore ordained separate ownership—and divestiture where necessary to reduce holdings to one system—as the " 'very heart' of the Act." *Id.*, at 180. Although Congress was aware that some economic loss might be suffered by the parent holding company or the separated integrated utility, Congress relented only to the extent of authorizing the Commission to permit retention of an additional integrated utility if that permission might be granted under the narrow exception provided by § 11 (b)(1). But "retention of an 'additional' integrated system is decidely the exception," and the burden is on the holding company to satisfy the "stringent test" set by the statute. *Id.*, at 180, 182; cf. *United States* v. *First City Nat'l Bank*, 386 U. S. 361, 366.

Congress committed to the Commission the task of determining whether a holding company has met the burden of showing that its situation falls within the narrow exception under § 11 (b)(1). The Clause A determination whether separation entails a loss of economies likely to cause a serious impairment of the system involves an element of prediction which necessarily calls for difficult and expert judgment. That judgment requires the assessment of many subtle and often intangible factors not easily expressed in precise or quantifiable terms. This is the very nature of economic forecasting. The task calls for expertise and is not simply "an exercise in counting commonplaces." *United States* v. *Drum*, 368 U. S. 370, 384; see *NEES I*, 384 U. S., at 184–185. Judicial review of that expert judgment is necessarily a limited one. See *Gray* v. *Powell*, 314 U. S. 402, 412–413; *NLRB* v. *Hearst Publications*, 322 U. S.

[5] "By fostering competition between gas and electric utility companies, the Act promotes what has been described as 'variegated competition.' " *NEES I*, 384 U. S., at 184, n. 15.

111, 131; *Atlantic Ref. Co.* v. *FTC*, 381 U. S. 357, 367–368; *United States* v. *Drum, supra*, at 375–376. Congress expressly provided that "[t]he findings of the Commission as to the facts, if supported by substantial evidence, shall be conclusive." 15 U. S. C. § 79x (a); see *Universal Camera Corp.* v. *NLRB*, 340 U. S. 474; cf. *NLRB* v. *Erie Resistor Corp.*, 373 U. S. 221, 236. In our view, the Court of Appeals in this case indulged in an unwarranted incursion into the administrative domain.[6] The Commission's order has adequate support in the record and should have been affirmed.

As of 1958, the test year selected for purposes of these proceedings,[7] NEES's eight gas subsidiaries provided retail service to some 237,000 customers in a relatively compact 660-square-mile franchise area in Massachusetts. NEES's electric companies also served 75% of this area and about 78% of the gas customers were also electric customers. NEES's gross investment in gas plant and equipment was about $56,300,000 and gross gas revenues for 1958 were about $22,700,000. The eight gas companies were organized administratively as a Gas Division with centralized management, marketing

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[6] The following passage is from the court's opinion on remand:

"Even without the burden of proving likely demise, [NEES's] burden is, as the Court said, to meet 'a much more stringent test' than that of a probable significant loss. But, if the standard to be applied to [NEES] is stringent, so is the level of analysis and expertise to be exercised by the Commission. We have, only after a fresh review of all the evidence in the light of this most stringent practical standard, concluded that the Commission's opinion does not reveal that application of both reason and experience to facts which merits endorsement as the responsible exercise of expertise." 376 F. 2d, at 111.

[7] This was the latest year for which audited financial statements were available at the time of the hearing before the Commission. 41 S. E. C., at 889, n. 3.

and supply, operations, and merchandising departments.[8] The chief executive of the Gas Division was also president of each gas company and ultimately responsible to NEES's vice president in charge of management; in short, top management rested with executives having joint control over both electric and gas operations.

The Commission had before it a "severance study," a cost analysis and projection prepared for NEES by a professional public utilities management consulting firm, Ebasco Services, Inc. This study projected a loss of economies of approximately $1,100,000 annually for the gas system as the result of its separation from NEES. The Commission dealt with this study in alternative ways. It analyzed the study and concluded that "[t]he Ebasco estimate is inadequately supported in a number of important aspects and leaves considerable doubts which [NEES has] not satisfactorily overcome in the record." Then it went on to find that even if the estimated $1,100,000 in loss of economies were accepted as accurate "it would not lead us to conclude that such a loss is so substantial, when compared with the loss of economies involved in prior divestment cases and viewed in light of the objectives of the Act, as to warrant retention of the gas properties . . . ." 41 S. E. C., at 895, 897. Because we conclude that the record supports the Commission's decision on the latter ground, we have no occasion to consider whether the Commission's strictures on the reliability of the Ebasco study are well founded.

The Commission's ultimate finding that the projected $1,100,000 loss of economies annually did not constitute a loss of "substantial" economies within Clause A of § 11 (b)(1) was reached primarily upon the basis of its

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[8] All but one of the eight companies are located within 48 miles of the division headquarters; one is 80 miles away.

subsidiary findings upon three matters: (1) That NEES's estimated losses were not significantly out of line with those found insubstantial in previous cases; (2) that other nonaffiliated Massachusetts gas companies,[9] all but one of them smaller than the NEES gas system, are apparently able to operate successfully without electric utility affiliations; (3) that NEES did not establish that independent management devoted solely to promoting gas sales would not result in benefits to offset some of the projected losses. The Court of Appeals held that none of the three subsidiary findings was supported by substantial evidence. We disagree.

I.

The Commission, consistent with its practice in prior cases,[10] weighed NEES's estimated $1,100,000 losses in relative rather than absolute terms, calculating the losses as a percentage of NEES's 1958 revenues, expenses, and income.[11] It found these loss ratios to be "lower or not significantly higher than corresponding ratios of gas systems whose divestment we have required on the ground that the estimated loss of economies was not substantial within the meaning of clause A." 41 S. E. C., at 898. The cases with which these particular comparisons were made involved companies outside Massachusetts.[12] The Court of Appeals held that the compari-

[9] "Nonaffiliated" or "independent" refers to gas companies not having any electric affiliations and gas companies not jointly operated with electric companies serving the same franchise area.

[10] *E. g., Philadelphia Co.,* 28 S. E. C. 35, 50–52 (1948); *General Pub. Util. Corp.,* 32 S. E. C. 807, 837 (1951).

[11] The losses would amount to: 4.8% of operating revenues; 6.0% of operating revenue deductions (excluding federal income taxes); 23.3% of gross income (before federal income taxes); 29.9% of net income (before taxes).

[12] See *Engineers Pub. Service Co.,* 12 S. E. C. 41, 55–61, 78–81 (1942); *North Amer. Co.,* 18 S. E. C. 611 (1945); *Philadelphia*

sons with the loss ratios of companies involved in prior cases were "largely irrelevant" because ". . . these ratios are significant only as they affect the investment structure of the companies in the particular case, and different companies may be compared only on the assumption that both operate at the same level." 376 F. 2d, at 113, 115. The court's ultimate conclusion was that only close analysis of NEES's own "particular circumstances" was relevant to the Commission's inquiry.

It is significant, however, that the Court of Appeals' criticism of the Commission's use of ratios relied heavily on the court's reading of the statistical data in evidence as showing that the projected loss of economies "would decrease [NEES's] rate of return from 6.4 per cent in 1959 to 4.1 per cent on the projected basis," or some 30% below, "an average rate of 5.9 per cent for the non-affiliated Massachusetts gas companies . . . ." 376 F. 2d, at 114. But, as the Commission has noted, the court's computation that the separated companies would realize a return of only 4.1% contained a serious error, for it overlooked the allowance to be made for income tax deductions generated by the projected losses. The actual rate of return taking such deductions into account would be a significantly higher 5.2%.[13]

In any event, we may agree that the ratios of losses of revenues, expenses, and income are necessarily affected by differences in capital structure, management, market position, and other factors. But it by no means follows

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*Co.*, 28 S. E. C. 35, 45–53 (1948); *General Pub. Util. Corp.*, 32 S. E. C. 807, 814–815, 823–839 (1951); *Middle So. Util., Inc.*, 35 S. E. C. 1 (1953), 36 S. E. C. 383 (1955). The relevant financial data for each case is summarized in an appendix to the Commission's opinion. 41 S. E. C., at 905.

[13] Rate of return is the percentage of net operating income to the rate base, which is fixed by a formula tied generally to the value of capital assets. The source of the 4.1% figure appears to

that the Commission's comparisons are for that reason irrelevant to the determination whether a projected loss of economies is so important as to cause a serious impairment of the separated system. It was well within the range of the Commission's administrative discretion to use the loss ratios, as it did, "as a guide in adjudicating the pending case." *Philadelphia Co.*, 28 S. E. C. 35, 50, n. 24. The Commission in its expert judgment may so employ evaluative factors it considers relevant.[14]

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have been the Court of Appeals. The 4.1% was apparently derived as follows:

(a) $\frac{\$\ 3{,}050{,}988 \text{ (1959 net oper. income after taxes)}}{\$47{,}723{,}162 \text{ (rate base)}}$ = 6.4% rate of return

(b) $ 3,050,988
− 1,098,600 (projected losses)
$ 1,952,388 (est. net oper. income)

(c) $\frac{\$\ 1{,}952{,}388}{\$47{,}723{,}162}$ = 4.1% rate of return

However, the $1,100,000 projected loss would generate income tax deductions of roughly 50%, increasing the numerator of fraction (c) from $1,952,388 to $2,501,688, and the rate of return to 5.2%. The NEES brief relies on the 4.1% figure, but NEES has not challenged the Commission's recalculation.

The 1959 rates of return for the comparable nonaffiliated Massasetts companies were as follows:

| | *Percent* |
|---|---|
| Berkshire Gas | 5.2 |
| Brockton-Taunton Gas | 6.1 |
| Fall River Gas | 6.2 |
| Haverhill Gas | 6.8 |
| Lowell Gas | 7.9 |
| Springfield Gas | 6.4 |
| Worcester Gas | 4.5 |

(Res. Ex. 117; R. 1436.)

[14] Although the parties are in dispute as to the validity of some of the data drawn from the previous cases, we do not consider it necessary to become involved in that controversy. Suffice it to say that we do not think the Commission in looking to the data for guidance exceeded the bounds of reason or administrative discretion.

Indeed, NEES apparently recognized that its burden to establish that its situation comes within Clause A included the burden of showing that the projected loss of economies would be more serious for its separated system than the comparable level of losses in the other cases already decided by the Commission. Respondent attempted to prove that the gas system's distance from sources of supply give it only a very narrow competitive advantage over oil as a fuel, and, further, that the system's growth potential is more limited by a lack of new housing expansion in the area serviced by the gas companies. As we shall see below, the Commission found that NEES had not made a case in either respect insofar as those matters bore on whether the projected loss of economies threatened serious impairment of the separated system.

## II.

The Commission's resort to data concerning the operations of the nonaffiliated Massachusetts gas companies was a response to NEES's argument, supported by the Massachusetts Department of Public Utilities, that the projected loss of economies from separation of the gas system would require the gas companies to seek rate increases which might seriously impair or destroy any hope of a successful operation. Natural gas in 1959 enjoyed in New England the smallest price advantage over oil of any section of the country. The differential was $7 over oil for a typical New England house compared with $27 to $118 in favor of gas in the rest of the country.[15] NEES contended that the predicted rate increase would substantially or entirely eliminate the gas

[15] Gas to New England was piped all the way from Texas, whereas oil was shipped in by tanker. NEES estimated the average home heating cost to be $166 for gas, $173 for oil; and it was in residential space heating that NEES found its chief market.

system's already narrow price advantage over oil competitors. The Commission's answer was to inquire about the economic health of the already nonaffiliated Massachusetts gas companies. The Commission found that these companies were apparently able to earn a fair return although not enjoying the supposed advantages of affiliation with electric utilities; and it could find no evidence that they did not face the same competitive conditions as NEES.[16] The Commission found further that, despite NEES's insistence that its market conditions differed from the nonaffiliated companies because of relatively stagnant franchise areas offering less sales growth,[17] there was no evidence that this would prevent the separated gas system—which would emerge as the second largest independent in the State—from competing as effectively as the smaller independents

[16] NEES calculated the composite rate of return for its gas system at 6.6% for 1958 and 6.4% for 1959. (Res. Ex. 114; R. 1431.) The average for seven comparable independents was 6.3% in 1958 and 5.9% in 1959. (Res. Ex. 117; R. 1436.)

[17] NEES cites as prime evidence in this regard the testimony of Robert Cahal, an Ebasco marketing consultant who had to some extent analyzed the marketing conditions NEES faced. The substance of his testimony was that (a) gas and oil are highly competitive in the State, with oil being well entrenched in many areas so that the major source of growth has to be in new residence construction; (b) in Massachusetts growth is in the suburbs with towns proper being relatively stagnant; (c) gas companies are limited by their franchise area, prisoners of the characteristics of their particular communities; (d) the independents are not necessarily comparable with NEES because they may be in areas of higher growth; (e) independents having such areas are Haverhill, Lowell, Springfield, Worcester, Brockton-Taunton; all of them having greater (but unspecified as to degree) growth than any NEES gas company except Norwood.

The Commission noted, without comment, that the population increase in NEES's franchise areas between 1950 and 1960 was only 11% as compared with 18% in the areas of seven independents. 41 S. E. C., at 899, n. 23.

who had long held their own. Finally, the Commission noted that after severance the gas system's operating ratio would be more favorable or only slightly higher than the ratios of nine independents and therefore concluded that it "would be entering the realm of speculation at this time to assume that rate increases would ensue from severance." 41 S. E. C., at 899.[18]

The Court of Appeals rejected the comparison of these operating ratios, again on the ground that such ratios fail to take account of special characteristics of individual companies. The court observed that since all New England gas companies operated on a "small cushion . . . [t]he significance of this is not negated by observing that non-NEES companies in Massachusetts seem to be surviving, for the focus must be on the specific characteristics of the NEES companies, the only ones affected by the Commission's order." 376 F. 2d, at 113. The court held further "irrelevant the comparison of operating ratios, since a business may operate relatively efficiently, yet at a level too low to attract investors." 376 F. 2d, at 114, n. 6. For the reasons already stated for our disagreement with the Court of Appeals' view of the Commission's use of other ratios, we disagree that this comparison was either irrelevant or outside the limits of the Commission's administrative discretion. The dissection and evaluation of an economic projection is a

[18] The operating ratio is "the percentage of total operating revenue deductions (other than depreciation, amortization of conversion costs, and Federal income taxes) to total operating revenues." 41 S. E. C., at 899, n. 25. The ratio "affords a measure for determining the efficiency with which the enterprise is conducted and while its value is greater in comparing the year to year trend it has a limited use in comparing very similar enterprises." Moody's Public Utility Manual ix (1967). NEES's ratio was fixed at 76.41% and compared with the composite ratio of nine independents of 79.14%, as well as their median and mean ratios of 74.87% and 76.35% respectively. Individual ratios are cited at 41 S. E. C., at 899, n. 26.

function Congress committed to the Commission, not the courts. A court may believe it would have done the job differently and better; but judicial inquiry must be addressed to whether what the Commission did is fatal to its ultimate conclusion that the holding company failed to carry its burden of showing a loss of "substantial" economies within the meaning of Clause A. In assessing NEES's forecast of the need for rate increases because of the projected loss of economies, it was proper for the Commission to consider the performance of other Massachusetts gas companies which were already operating independently. NEES was afforded every opportunity to sustain its burden of showing that the separated gas system would wither into critical health despite the contrary inferences suggested by the comparison made by the Commission. It cannot be a basis for finding error that the Commission found the attempt unpersuasive, given the gas system's size,[19] and the prognosis of efficiencies comparable to those achieved by the independents.[20]

## III.

The Commission conceived that the projected loss of economies would in some measure be offset by advantages realized by the separated system under the direction of "a management solely interested in and devoted to the gas operations . . . ." 41 S. E. C., at 901. NEES,

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[19] The Commission may properly regard size of operation to be a relevant factor. One of Congress' concerns in providing the exception involved here was to protect small companies likely to fail if separated from the parent holding company. Cf. NEES I, 384 U. S., at 181; *North Amer. Co.* v. *SEC,* 327 U. S. 686, 697. See also H. R. Rep. No. 1903, 74th Cong., 1st Sess, 68–71; S. Doc. No. 92, 70th Cong., 1st Sess., Pt. 72–A, at 831, 835. And NEES's size, especially given its relatively compact franchise area, is some indication of its competitive position.

[20] See n. 18, *supra,* and accompanying text.

again supported by the Massachusetts Department of Public Utilities, took the position that its operation of the companies had already achieved all possible benefits of interservice competition. The Commission found the argument unpersuasive, relying again on a comparison with the nonaffiliated Massachusetts gas companies. This was a comparison of the sales performance of the gas companies under NEES management with the sales performances of the independents. All seven of the comparable independents showed substantially higher gas sales and revenues per customer and lower costs to customers.[21] The Commission found unpersuasive NEES's explanation that this was accounted for by the greater residential growth potential of the areas serviced by the independents.[22]

The Court of Appeals held that the test of "serious impairment" under Clause A already took account of offsetting benefits to be realized from separation and therefore "that done, the general judgment has no inde-

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[21] The breakdown was as follows:

| | *NEES* | *Indep.* |
|---|---|---|
| 1958— | | |
| Sales, mcf/cust | 44.2 | 78.8 |
| Revenues, cust | $95.44 | $135.19 |
| Cost to Customers, mcf | $2.16 | $1.72 |
| 1959— | | |
| Sales, mcf/cust | 51.5 | 83.7 |
| Revenues, cust | $104.49 | $142.10 |
| Cost to Customers, mcf | $2.03 | $1.70 |

Equivalent data for the Norwood Gas Company, the NEES subsidiary asserted to have growth potential comparable to the independents, see n. 17, *supra*, was as follows (1958 and 1959 figures): Sales—51.8 and 60.4 mcf/customer; Revenues—$112.59 and $125.66/customer; Costs to customers—$2.17 and $2.08/mcf. 41 S. E. C., at 901, nn. 29–30. See R. 1446–1447, 1449–1450.

[22] "[N]o specific demonstration of the existence or extent of such a causal relation was presented." 41 S. E. C., at 901. See also n. 21, *supra*.

pendent significance in an individual case." 376 F. 2d, at 115–116. Whatever the merit of the general premise, see *NEES I*, 384 U. S., at 184–185, we understand the Commission's finding to have been simply that the projected $1,100,000 loss of economies did not in fact take into account any offsetting benefits on the assumption that joint operation had already achieved the advantages of independence. See 41 S. E. C., at 900–901. The Commission's conclusion that NEES's assumption was not proved has support in the record and the Court of Appeals was not justified in rejecting it.

The judgment of the Court of Appeals is reversed and the case is remanded to that court with direction to enter a judgment affirming the Commission's order.

*It is so ordered.*

Mr. Justice Douglas and Mr. Justice Marshall took no part in the consideration or decision of this case.

# SUPREME COURT OF THE UNITED STATES

No. 305.—October Term, 1967.

Securities and Exchange Commission, Petitioner, *v.* New England Electric System et al. | On Writ of Certiorari to the United States Court of Appeals for the First Circuit.

[March 5, 1968.]

Mr. Justice Harlan, whom Mr. Justice Stewart joins, concurring.

Given the earlier decision of the Court in this case, *SEC* v. *New England Electric System*, 384 U. S. 176, which I continue to believe wrongly construed the statute but by which I consider myself bound, I join today's opinion of the Court.